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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 127

EVELYN F. GREGORY, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR CERTIORARI FILED JUNE 23, 1934.

CERTIORARI GRANTED OCTOBER 8, 1934.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. 127

EVELYN F. GREGORY, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 55299

EVELYN F. GREGORY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Taxpayer: Albridge C. Smith, Esq., George W. Saam, Esq.
For Comm'r: E. L. Corbin, Esq.

1931.

Apr. 3. Petition received and filed. Taxpayer notified. (Fee paid.)
" 3. Copy of petition served on General Counsel.
Oct. 2. Answer filed by General Counsel.
" 10. Copy of answer served on taxpayer. General Calendar.

1932.

Aug. 11. Hearing set Oct. 10, 1932.
Oct. 10. Notice of the appearance of Geo. W. Saam as counsel for taxpayer filed.

[fol. 2]

Oct. 10. Hearing had before Mr. Sternhagen, Div. 10 on merits. Submitted. Brief due Nov. 14, 1932, reply briefs due Nov. 24, 1932—exchange by parties.
" 19. Transcript of hearing of Oct. 10, 1932 filed.
Nov. 14. Brief filed by taxpayer. 11/14/32 copy served.
" 14. Brief filed by General Counsel.
" 24. Reply brief filed by taxpayer.
Dec. 6. Opinion rendered, Mr. Sternhagen, Div. 10. Judgment will be entered under Rule 50.

1933.

Jan. 3. Notice of settlement under Rule 50 filed by taxpayer. 1/10/33 copy served.

" 6. Hearing set Jan. 23, 1933 on settlement under Rule 50.

" 25. Hearing had before Mr. Marquette, Div. 1, on merits. Settlement under Rule 50—not contested—referred to Mr. Sternhagen.

" 26. Judgment entered, Div. 10. Mr. Sternhagen.

Mar. 20. Motion to vacate judgment of Jan. 26 filed by taxpayer.

" 20. Stipulation as to deficiency filed.

" 25. Order that judgment entered Jan. 26, 1933 be vacated and judgment entered, Mr. Sternhagen, Div. 10.

[fol. 3]

June 19. Petition for review by U. S. Circuit Court of Appeals (2) with assignments of error filed by General Counsel.

" 23. Proof of service filed on taxpayer.

" 27. Proof of service on taxpayer's attorney filed.

Aug. 14. Motion for extension to 10/1/33 to complete record filed by General Counsel.

" 14. Order enlarging time to Oct. 30, 1933 for preparation of evidence and delivery of record entered.

Oct. 19. Motion for extension to 10/29/33 to complete the record filed by General Counsel.

" 19. Order enlarging time to Nov. 29, 1933 for preparation and delivery of record entered.

Nov. 18. Statement of evidence lodged.

" 23. Statement of evidence approved and ordered filed.

" 27. Præcipe with proof of service thereon filed by General Counsel.

" 28. Motion for extension to Jan. 2, 1934 to transmit record filed by General Counsel.

" 28. Order enlarging time to Jan. 2, 1934 for transmission of record entered.

[fol. 4] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION

The above-named petitioner hereby petitions for re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing symbols: IT:AR:MPB-60D A-2 dated February 12, 1931, and as a basis of this proceeding alleges as follows:

1. The petitioner is an individual with a residence at 1423 Albemarle Road, Brooklyn, New York.

2. The notice of deficiency, a copy of which is attached and marked Exhibit "A", was mailed to the petitioner on February 12, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928 and are for $10,678.16.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

[fol. 5] (a) The elimination from capital net gain taxable at the rate of 12½% of $76,007.88 (being the difference between $133,333.33, the value of 1,000 shares of common stock of Monitor Securities Corporation received by petitioner from Averill Corporation on the liquidation thereof, and $57,325.45, the cost to petitioner of the stock of Averill Corporation.)

(b) The addition to the net income of $133,333.33 as a dividend received by petitioner from the United Mortgage Corporation.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) United Mortgage Corporation is a corporation organized under the laws of the State of New York, having a capital stock represented by 5,000 shares of the par value of $100 a share.

(b) Petitioner was at all times during the year 1928 from and after January 3, 1928, the owner of 5,000 shares of the capital stock of United Mortgage Corporation. Said 5,000 shares then constituted and still constitute the entire out-

standing capital stock of United Mortgage Corporation and were acquired by petitioner as follows:

[fol. 6] October 1, 1920	19 shares	
November 1, 1920	800 shares	
December 31, 1920	6 shares	
January 1, 1921	10 shares	
April 10, 1921	250 shares	
November 18, 1921	300 shares	
November 18, 1921	115 shares	—100% Stock Dividend
December 15, 1921	1500 shares	
December 16, 1921	300 shares	
January 12, 1927	475 shares	
January 15, 1927	200 shares	
April 13, 1927	125 shares	
April 13, 1927	75 shares	
December 29, 1927	225 shares	
January 3, 1928	600 shares	
	5000 shares	

(c) Averill Corporation is a corporation organized on or about September 18, 1928, under the laws of the State of Delaware, with a capital stock consisting of 500 shares of the par value of $10 each.

(d) On September 21, 1928, United Mortgage Corporation and Averill Corporation entered into an agreement whereby United Mortgage Corporation agreed to transfer to Averill Corporation 1,000 shares of the common stock of Monitor Securities Corporation, owned by United Mortgage Corporation, in exchange for the entire capital stock of Averill Corporation, to be distributed pro rata to the stockholders of United Mortgage Corporation. Said 1,000 shares of common stock of Monitor Securities Corporation [fol. 7] had been acquired by United Mortgage Corporation by purchase on January 6, 1922.

(e) On September 21, 1928, pursuant to this agreement United Mortgage Corporation transferred to Averill Corporation said 1,000 shares of common stock of Monitor Securities Corporation and petitioner acquired the entire outstanding capital stock of Averill Corporation, consisting of 500 shares, without the surrender by petitioner of any of the stock of United Mortgage Corporation owned by her.

(f) At the time of the transaction described in subpara-

graph (e) above, the market value of the assets of United Mortgage Corporation was $814,064.25. The value of 1,000 shares of the common stock of Monitor Securities Corporation included in such assets was $133,333.33, or 16.3787% of the value of the entire assets of United Mortgage Corporation. The cost to petitioner of the 5,000 shares of United Mortgage Corporation was $350,000. The cost to the petitioner of the 500 shares of the capital stock of Averill Corporation was 16.3787% of $350,000 or $57,325.45.

(g) On September 24, 1928, Averill Corporation was dissolved and, in liquidation, distributed in kind to its stockholders its entire assets consisting of 1,000 shares of common stock of Monitor Securities Corporation. Pursuant to such liquidation, petitioner became the owner of 1,000 shares of the common stock of Monitor Securities Corpora- [fol. 8] tion, having a value at the time of such distribution and liquidation of $133,333.33.

(h) On September 24, 1928, petitioner sold the 1,000 shares of the common stock of Monitor Securities Corporation received from Averill Corporation for $133,333.33.

(i) On or prior to March 15, 1929, the petitioner duly filed her income tax return with the Collector of Internal Revenue for the First District, New York, and reported thereon the receipt of a capital net gain of $76,007.88 (the difference between $133,333.33, the value at the time of distribution of the 1,000 shares of common stock of Monitor Securities Corporation, and $57,325.45, the cost to her of the capital stock of Averill Corporation) and paid a tax thereon at the rate of 12½%. A complete statement of the items reported by the petitioner in her income tax return for the year 1928 is as follows:

Interest received	$1,484.88
Interest received on bonds having a tax-free covenant clause	1,097.93
Dividends on stocks of domestic corporations	7,162.50
	$9,745.31
Deductions	482.88
Ordinary Net Income	$9,262.43
Capital net gain on various securities (including the $76,007.88 gain derived from the common stock of Monitor Securities Corporation)	$97,603.43

[fol. 9] (j) The petitioner on the basis of such return paid a tax of $12,178.47.

(k) The Commissioner of Internal Revenue in his determination of the tax liability of petitioner has eliminated from capital net gain the sum of $76,007.88 and has added to net income the sum of $133,333.33 as a dividend received by petitioner from United Mortgage Corporation. On the basis of such determination the Commissioner of Internal Revenue has assessed against petitioner an additional tax of $10,678.16.

Wherefore the petitioner prays that this Board may hear the proceeding and determine (1) that the petitioner correctly reported in her income tax return for the year 1928, the receipt by her of 1,000 shares of common stock of Monitor Securities Corporation as a capital net gain of $76,007.88, taxable at the rate of 12½%; (2) that $133,333.33, the value of 1,000 shares of common stock of Monitor Securities Corporation, should not be added to net income as a dividend received by petitioner for the year 1928; and (3) that no deficiency in income tax due from the petitioner for the year 1928, exists.

Evelyn F. Gregory, Petitioner. Albridge C. Smith, Counsel for Petitioner. Humes, Buck, Smith & Stowell, Office and Post Office Address: 50 Broadway, Borough of Manhattan, City and State of New York.

[fol. 10] *Duly sworn to by Evelyn F. Gregory. Jurat omitted in printing.*

[fol. 11] EXHIBIT "A" TO PETITION

NP-2-28.

IT:AR:A-2.
MPB-60D.
Copy mailed Feb. 12, 1931.

Mrs. Evelyn F. Gregory, 1423 Albemarle Road, Brooklyn, New York.

MADAM: You are advised that the determination of your tax liability for the year(s) 1928 discloses a deficiency of $10,678.16, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permiting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is [fol. 12] made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by
(Signed) J. C. Wilmer, Deputy Commissioner.

Enclosures: Statement. Form 882. Form 870.
Ke-4

BEFORE UNITED STATES BOARD OF APPEALS

[Title omitted]

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition of this taxpayer admits and denies as follows:

[fol. 13] 1. Admits the allegations contained in paragraph 1.

2. Admits that the notice of deficiency was mailed to the petitioner on February 12, 1931. Denies the other allegations contained in paragraph 2.

3. Admits the allegations contained in paragraph 3.

4(a) and (b). Denies that the Commissioner erred as stated in sub-paragraphs (a) and (b) of paragraph 4.

5(a) to (k), inclusive. Denies the allegations contained in sub-paragraphs (a) to (k), inclusive, of paragraph 5.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: James L. Backstrom, Special Attorney, Bureau of Internal Revenue.

[fol. 14] BEFORE UNITED STATES BOARD OF TAX APPEALS

27 B. T. A.

Docket No. 55299

EVELYN F. GREGORY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Promulgated December 6, 1932.

Petitioner, the only shareholder of U Company, caused A Company to be organized. U Company transferred assets, consisting of shares in M Company, to A Company for which A Company issued all its shares to petitioner. A Company then liquidated by distributing its assets, consisting of shares in M Company, to petitioner, its only shareholder, and immediately dissolved. Petitioner then sold the shares in M Company. Held, A Company may not be disregarded, and tax to petitioner is predicated upon the statutory recognition of a reorganization, liquidation and sale, with consequent gain or loss, and not upon an assumed dividend to petitioner by U Company.

George W. Saam, Esq., for the petitioner.

E. L. Corbin, Esq., for the respondent.

OPINION

[fol. 15] STERNHAGEN:

The respondent determined a deficiency of $10,678.16 in the petitioner's income tax for 1928, all of which is assailed

by the petitioner on the ground that the respondent has erroneously treated $133,333.33 as a dividend from the United Mortgage Corporation. There is no dispute about the facts, both parties having agreed that they are essentially as set forth in the report of a revenue agent.

The petitioner was the owner of all the outstanding (5,000) shares of the United Mortgage Corporation. Of these, 3,300 shares had been purchased between October 1, 1920, and December 16, 1921, at a cost of $180,000, and 1,700 shares between January 12, 1927, and January 3, 1928, at a cost of $170,000. The United corporation had among its assets 1,000 shares of the Monitor Securities Corporation. On September 18, 1928, the Averill corporation was organized under Delaware law. On September 20, 1928, the United corporation transferred to the Averill corporation the 1,000 shares of Monitor stock, in consideration for which the Averill corporation issued its shares to the petitioner. On September 24, 1928, the Averill corporation liquidated and dissolved, thus distributing its entire assets, consisting of the Monitor shares to its only shareholder, the petitioner. On the same date as the liquidation distribution, petitioner sold the Monitor shares for $133,333.33.

In her return, she treated these several transactions as governed by the several reorganization provisions of the statute, and returned as capital net gain derived from the [fol. 16] sale price of $133,333.33 the amount of $76,007.88 upon an apportioned cost basis of $57,325.45.

None of the foregoing facts or figures is in dispute, the respondent conceding that if the petitioner was legally correct in applying the reorganization provisions of the statute to the situation, her computation of gain is correct. His determination is based upon the view that the creation of the Averill corporation was without substance and must therefore be disregarded, and that the petitioner must be taxed as upon a dividend consisting of the amount received upon the sale of the Monitor shares as if such amount had been distributed by the United corporation directly to her. He argues that the mere organization of the Averill corporation for the purpose, as it is conceded, of enabling the petitioner and the United corporation to avoid tax, followed almost immediately by the dissolution of the Averill corporation, was a transparent fiction.

In our opinion, the respondent erred in disregarding the Averill corporation. During the short period of its exist-

ence it performed its function of issuing its shares, taking and holding the Monitor shares, and then distributing them in liquidation. As long as corporations are recognized before the law as if they were creatures of substance, there is nothing to distinguish this corporation from innumerable others, whether they be devised to achieve a temporary tax reduction or some other legitimate end. Congress has not left it to the Commissioner to say, in the absence of fraud or other compelling circumstance, that the corporate form may be ignored in some cases and recognized in others. [fol. 17] Whatever can be said of the wisdom of recognizing the corporate device, the taxing statutes have so plainly accepted it and provided the detailed methods of taxing its transactions, that to disregard it in a case like this would vary the time, method and amount of tax which the statute imposes.

The purpose to reduce taxes does not control the recognition of the corporation, Bullen v. Wisconsin, 240 U. S. 625, nor does the extent of its legitimate function or operations. Its existence can not be denied to escape liability, Nowland Realty Co. v. Commissioner, 47 Fed. (2d) 1018; People v. Williams, 198 N. Y. 54; 91 N. E. 266; 112 West 59th Street Corp., 23 B. T. A. 767, and with equal force it may enjoy its corporate benefits. That the petitioner was its sole shareholder does not serve to obscure its identity, Planters Cotton Oil Co., Inc. v. Hopkins, 286 U. S. 332, else the United corporation would likewise be obliterated, and this is not suggested. The shortness of its life does not indicate less than a complete entity while it lived. Regal Shoe Co., 1 B. T. A. 896.

It should be remembered when considering the effects upon tax liability of corporate plans that the statute has, since the Act of 1918, provided in more or less detail the system of tax determination, and this system unmistakably permits the bona fide use of the corporate device. That its effect may be, as here, to tax a profit piecemeal over several periods is so clearly within the legislative system that it can not be denied. As a result of it, the benefit of one year may be the burden of another; and the incidence of the statute may be as favorable to the govern- [fol. 18] ment in one case as it is unfavorable in another. A statute so meticulously drafted must be interpreted as a literal expression of the taxing policy and leaves only the

small interstices for judicial consideration. The general legislative plan apparently was to recognize the corporate entity and, in view of such recognition, to specify when the gains or losses would be recognized and upon what basis they should be measured. We may not destroy the effectiveness of this statutory plan by denying recognition to the corporation and thus preventing consideration of its transactions.[1]

The recognition of the Averill corporation being determined, it follows as the respondent concedes, that the petitioner's computation of gain was correct. There was a statutory reorganization under Revenue Act of 1928, section 112(i), and hence no gain to the petitioner as distributee from the United corporation of the Averill shares, section 112(g). See Miller on Reorganizations, ch. 13. The effect was to apportion the basis formerly applicable to petitioner's United shares between the United shares and the Averill shares, section 113(a) (9); Reg. 74, Art. 600; Miller on Reorganization, ch. 20. The liquidation of the Averill corporation, whereby petitioner received the Monitor shares, resulted in gain or $76,007.88, the difference between the undisputed basis of $57,325.45 attributed to the Averill shares, and $133,333.33, the undisputed value of the Monitor shares so received section 115(c). The immediate [fol. 19] sale by petitioner of the Monitor shares for no more than their value as used in the foregoing computation resulted in the realization by her of no further gain. See Edgar J. Hesslein, 21 B. T. A. 61, affirmed 53 Fed. (2d) 1081; I. T. 2259, V-1 C. B. 18; I. T. 2530; IX-1 C. B. 194.

Since only 3,300 of her United shares were held by petitioner more than two years, her gain was subject to the capital gains provision, section 101, only to a like extent. This the petitioner concedes.

Judgment will be entered under Rule 50.

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[1] Section 112 (k), Revenue Act of 1932, is an indication that when a corporation is not to be "considered as a corporation" the statute expressly says so.

BEFORE UNITED STATES BOARD OF TAX APPEALS—
WASHINGTON

[Title omitted]

JUDGMENT

Subsequent to the Board's report of December 6, 1932, 27 B. T. A. 223, the petitioner filed a proposed judgment which was duly set for hearing. No objections having been made by the respondent, it is

[fol. 20] Ordered, adjudged and decided that there is no deficiency in income tax for 1928.

Enter.

(Signed) John M. Sternhagen, Member.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 55299

EVELYN F. GREGORY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER VACATING JUDGMENT AND SUBSTITUTED JUDGMENT

Pursuant to the motion filed by petitioner March 20, 1933, to which is appended a stipulation of both parties, it is

Ordered that the judgment entered January 26, 1933, be and it hereby is vacated and set aside; and in substitution therefor it is

Ordered, adjudged and decided that there is no deficiency in petitioner's income tax for 1928 and that there is an over-payment of said tax of $974.70.

Enter.

(Signed) John M. Sternhagen, Member.

[fol. 21] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Sewall Key, Special Assistant to the Attorney General, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and Dean P. Kimball, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue, appointed and holding office by virtue of the laws of the United States; that Evelyn F. Gregory (hereinafter called the taxpayer) is an individual, a citizen of the United States and an inhabitant of the [fol. 22] State of New York, which is within the jurisdiction of the United States Circuit Court of Appeals for the Second Circuit; that more particularly her residence is 1423 Albemarle Road, Brooklyn, New York.

II

That the nature of the controversy is as follows, to-wit:

The taxpayer was at all times during the year 1928 material hereto the sole stockholder of the United Mortgage Corporation. At that time she owned 5,000 shares, which constituted the entire outstanding capital stock of said corporation, and of these 3,300 shares had been purchased between October 1, 1920, and December 16, 1921, at a cost of $180,000.00, and 1,700 shares between January 12, 1927, and January 3, 1928, at a cost of $170,000.00.

The United Mortgage Corporation had among its assets 1,000 shares of the Monitor Securities Corporation.

The taxpayer and also the United Mortgage Corporation desired to dispose of this last-mentioned stock in such manner as to avoid tax. With that end in view, the Averill Corporation was organized under Delaware law on Sep-

tember 18, 1928. To this corporation the United Mortgage Corporation, on September 20, 1928, transferred the 1,000 shares of Monitor stock, in consideration for which the Averill Corporation issued all its shares to the taxpayer. On or about September 24, 1928, the Averill Corporation liquidated and dissolved, and in doing so distributed its entire assets, which consisted of the Monitor shares, to its [fol. 23] only shareholder, who was the taxpayer.

On the same day that the taxpayer received the Monitor shares in distribution, she sold them for $133,333.33. In her 1928 return the taxpayer reported a capital net gain as the result of the transactions above mentioned in the amount of $76,007.88. This was predicated upon a sales price of $133,333.33 and an apportioned costs basis of $57,325.45.

The Commissioner, however, treated the distribution of said Monitor stock as an ordinary dividend in the amount of $133,333.33. This determination was based upon the view that the Averill Corporation should be disregarded and the receipt of the Monitor stock considered as if the same had been distributed by the United Mortgage Corporation directly to the taxpayer. As the result of his determination, the Commissioner asserted a deficiency in tax liability for 1928 in the amount of $10,678.16.

III

That the taxpayer appealed from said determination of the Commissioner to the United States Board of Tax Appeals; that the Board sustained the position of the taxpayer and ruled that the distribution to the taxpayer of the Monitor stock did not constitute an ordinary dividend but a distribution in liquidation of the Averill Corporation; that the Board ordered and decided that there was an overpayment of income tax for the year 1928 in the amount of $974.70; that the Board's findings of fact and opinion were promulgated December 6, 1932, and its final order of re- [fol. 24] determination adjudging that there was an overpayment of $974.70 was entered March 25, 1933.

IV

That said Commissioner, being aggrieved by the conclusions of law made by the Board of Tax Appeals in its said report and also by the said order of redetermination, de-

sires to obtain a review of said report and order by the United States Circuit Court of Appeals for the Second Circuit and as reasons for such review he alleges that the Board, in rendering its opinion and entering its final order of redetermination, committed the following errors:

1. The Board erred in failing to hold that the receipt by the taxpayer of the Monitor stock was taxable to her as an ordinary dividend;

2. The Board erred in failing to hold that the receipt by the taxpayer of the Averill stock was taxable to her as an ordinary dividend;

3. The Board erred in holding that the receipt by the taxpayer of the Monitor stock was taxable to her as a liquidating dividend from the Averill Corporation;

4. The Board erred in failing to disregard corporate existence of the Averill Corporation;

5. The Board erred in failing to treat the distribution to the taxpayer of the Monitor stock as a distribution by the United Mortgage Corporation;

[fol. 25] 6. The Board erred in failing to hold that the cancellation of its stock by the Averill Corporation and the accompanying distribution to the taxpayer of the Monitor stock was made at such time and in such manner as to be the essential equivalent of an ordinary dividend.

7. The Board erred in failing to affirm the Commissioner's determination.

8. The Board erred in deciding that there was an overpayment in tax for the year 1928 in the amount of $974.70.

Wherefore the Commissioner petitions that said report and decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with the law and with the rules of said court and be transmitted to the clerk of said court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said court.

(Sgd.) Sewall Key, Special Assistant to the Attorney General. (Sgd.) E. Barrett Prettyman, Gen-

eral Counsel, Bureau of Internal Revenue. Of Counsel: (Sgd.) Dean P. Kimball, Special Attorney, Bureau of Internal Revenue.

[fol. 26] UNITED STATES OF AMERICA,
District of Columbia, ss:

E. Barrett Prettyman, being duly sworn, says that he is General Counsel of the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Sgd.) E. Barrett Prettyman.

Sworn and subscribed to before me this 17th day of June, 1933. (Sgd.) Marcellette M. Taylor, Notary Public. My Commission expires March 31, 1935.

[fol. 27] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW

To Mrs. Evelyn F. Gregory, 1423 Albemarle Road, Brooklyn, New York:

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of June, 1933, file with the Clerk of the United States Board of Tax Appeals, Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 19th day of June, 1933.

(Sgd.) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue.

[fol. 28] Service of the above and foregoing notice, together with a copy of the petition for review and assign-

ments of errors mentioned therein, was made June 20, 1933, upon the undersigned who represented the respondent herein before United States Board of Tax Appeals.

(Sgd.) George W. Saam.

IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW

To George W. Saam, Esq., Humes, Buck, Smith & Stowell, 50 Broadway, New York, N. Y.:

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of June, 1933, file with [fol. 29] the Clerk of the United States Board of Tax Appeals, Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 19th day of June, 1933.

(Sgd.) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue.

Service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, was made June 21, 1933, upon the undersigned who represented the respondent herein before United States Board of Tax Appeals.

George W. Saam.

[fol. 30] IN UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SECOND CIRCUIT

Docket No. 55299

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

v.

EVELYN F. GREGORY, Respondent

Statement of Evidence

This cause came on for hearing before the Hon. John M. Sternhagen, Member of the United States Board of

Tax Appeals at Washington, D. C., on October 10, 1932. Evelyn F. Gregory (hereinafter referred to as "the taxpayer") appeared by her attorney George W. Saam; and the Commissioner of Internal Revenue (hereinafter referred to as "the Commissioner") appeared by his attorneys, C. M. Charest, General Counsel, Bureau of Internal Revenue, and E. L. Corbin, Special Attorney, Bureau of Internal Revenue.

REPRESENTATIONS AS TO FACTS

Thereupon the attorney for the taxpayer made the following representations to the Board of Tax Appeals with respect to the facts of the case:

"In 1928 Mrs. Gregory, the taxpayer, was the sole stockholder of the United Mortgage Corporation. She owned 5,000 shares constituting their entire outstanding capital stock. She had acquired this stock at various times since the year 1920. The United Mortgage Corporation owned [fol. 31] 1,000 shares of the stock of the Monitor Securities Corporation and those are the shares of stock which are in question in this case.

"In 1928 certain bankers began negotiations for the purchase of all of the stock of the Monitor Securities Corporation. The United Mortgage Corporation, with 1,000 shares, had only a small minority interest of the total outstanding stock of the Monitor Securities Corporation, which amounted to 45,000 shares of the common stock. It became evident that, if the United Mortgage Corporation sold the stock, double taxation would accrue; that is, a tax to the corporation and a tax to Mrs. Gregory on the distribution to her as a stockholder, as a dividend. She, in conference with attorneys, frankly sought a way to avoid the payment of a double tax.

"On the basis of this, Averill Corporation was formed in the State of Delaware on or about September 21, 1928. Averill Corporation entered into a plan of reorganization with United Mortgage Corporation, which provided that United Mortgage Corporation should transfer part of its assets, consisting of 1,000 shares of common stock of the Monitor Securities Corporation, to Averill Corporation in exchange for the issuance by Averill Corporation of its entire outstanding and issued capital stock, to Mrs. Gregory as the sole stockholder of the United Mortgage Cor-

poration, without the surrender by Mrs. Gregory of any of her stock or other securities in United Mortgage Cor-
[fol. 32] poration. This plan was carried out on or about the 21st of September, 1928. Averill Corporation thereafter immediately began proceedings for its dissolution. They were begun on or about September 21, 1928, and concluded September 24, 1928. Averill Corporation distributed, in complete liquidation, 1,000 shares of Monitor Securities Corporation stock to Mrs. Gregory, in kind, in complete and final liquidation. Mrs. Gregory immediately thereafter sold the 1,000 shares of common stock of Monitor Securities Corporation, which she had received from Averill Corporation in complete liquidation, and which 1,000 shares also constituted the entire assets of Averill Corporation. She sold 1,000 shares of Montor Securities common stock for $133,333.33. Mrs. Gregory filed her income tax return and reported gain on the sale of this stock.

"The cost to Mrs. Gregory of the entire 5,000 shares of United Mortgage Corporation stock was $350,000.00. She retained all of that stock and still has it to-day. There have been no transfers of any kind in that stock since January 3, 1928, which is the last date on which she acquired the last block of the stock.

"In view of the fact that the distribution of the 1,000 shares of Monitor Securities Corporation stock to Mrs. Gregory occurred at the same time as the sale of said stock by her, the value of the stock to her would be exactly the same as the sale price; there could be no difference. That is, there was no difference between the value of Monitor stock, the 1,000 shares, at the time she received it in dis-
[fol. 33] solution of the Averill Corporation, and the amount for which she sold that stock. We admit she realized a gain immediately upon dissolution and distribution in kind to her of the Monitor stock from Averill Corporation, based on the value of the stock, at that time. * * * I am conceding that $133,333.33 is the value of the stock of the Monitor Securities Corporation at the time it was distributed to Mrs. Gregory; and the parties agree that, if the value of said stock is a factor to be considered, $133,333.33 is the right value.

"There are very few facts in dispute between the parties. The taxpayer has always shown the Department all of her records and has frankly admitted that the object and purpose of the plan of reorganization and the reorgan-

ization was for the purpose of reducing taxes in the best possible way."

Thereupon there was offered and received in evidence, as Petitioner's Exhibit 1, the letter from the Commissioner of Internal Revenue to the taxpayer, asserting the deficiency in tax which is here involved. Said letter is the same as the letter which is attached as Exhibit A to the taxpayer's petition to the Board of Tax Appeals, set forth in this record, except that it also includes the following statement with respect to the tax liability:

[fol. 34] "Statement

IT:AR:A-2.
MPB-60D.

In re Mrs. Evelyn F. Gregory, 1423 Albemarle Road, Brooklyn, New York

Tax Liability

Year	Tax liability	Tax assessed	Deficiency
1928	$22,856.63	$12,178.47	$10,678.16

"The report of the internal revenue agent in charge at Brooklyn, New York, dated March 29, 1930, is approved and is hereby made a part of this letter.

"Careful consideration has been given to your protests relative to the adjustments made by the agent. However, the action of the agent in increasing dividends by $133,333.33 and reducing capital net gain by $76,007.88 is sustained by this office.

"Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1928 the Bureau will be unable to afford you an opportunity under the provisions of article 1211 of Regulations 69 and/or article 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 274(a) of the Revenue Act of 1926 and/or section 272(a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency."

[fol. 35] Thereupon there was offered and received in evidence, as Petitioner's Exhibit 2, the conference memo-

randum and report transmitted to the Commissioner of Internal Revenue by the Internal Revenue Agent in Charge at Brooklyn, New York. The taxpayer admitted that all of the facts and figures stated in said memorandum and report were true; and the parties agreed that said memorandum and report might be regarded and used as a stipulation of facts. Said memorandum and report contains the following statements:

"Field Conference Report

Office of Internal Revenue Agent in Charge, Brooklyn, New York

Conference date: October 24, 1930.
Taxpayer: Evelyn F. Gregory.
Address: 1423 Albemarle Road, Brooklyn, N. Y.

Statement of Fact

"Taxpayer is a married individual, who filed a separate return for the year 1928 on the cash receipts and disbursements basis. She was not engaged in business.

"The examining officer in his report added to dividend income the amount of $133,333.33, received on the sale of 1,000 shares of Monitor Securities Corporation stock, and eliminated the capital gain of $76,007.88 reported by the taxpayer on this transaction:

"The relevant facts are stated in Schedule 1-a of the examining officer's report in part as follows:

[fol. 36] 'Schedule No. 1-A

Explanation of Items Changed

'Addition to income $133,333.33.

'Represents a dividend in the form of 1,000 shares of common stock of Monitor Securities Corporation, market value $133,333.33, received by the taxpayer from the United Mortgage Corporation (Section 115(a), Revenue Act of 1928, Article 627, Regulations 74).

'Taxpayer deemed the acquisition of the Monitor Securities Corporation stock to be in pursuance of a reorganization of the United Mortgage Corporation coming under Section 112(b) of the Act, rather than a dividend, and reported the subsequent sale of the stock as capital

net gain (Section 101 of the Act). A cost basis was arrived at by her substantially in accordance with Paragraph (2), Article 600, Reg. 74.

'Taxpayer owned 5,000 shares of stock of the United Mortgage Corporation, representing its entire capital stock. This corporation held among its assets 1,000 shares of Monitor Securities Corporation stock, which it acquired by purchase January 6, 1922, for $10,413.07.

'Under date of September 21, 1928, the United Mortgage Corp. transferred the 1,000 shares of Monitor Securities Corporation stock to the Averill Corporation, a holding company (incorporated in Delaware September 18, 1928), and in accordance with agreement, the Averill Corporation was to issue its capital stock in the name of United Mort- [fol. 37] gage Corporation stockholders as their respective interests may appear. This was effected September 21, 1928, the taxpayer, Evelyn F. Gregory, thereby came into possession of the entire capital stock of the Averill Corp., consisting of 500 shares of stock having a par value of $10.00 a share.

'Under date of September 24, 1928, the Averill Corporation was dissolved and pursuant to the dissolution, the Averill Corporation turned over its assets in liquidation to its stockholders. The assets consisted solely of the 1,000 shares of Monitor Securities Corporation stock turned over to it by the United Mortgage Corporation as previously explained. By virtue of the taxpayer owning the entire capital stock of the Averill Corporation, acquired as previously shown, she obtained possession of the 1,000 shares of Monitor Securities Corporation stock, September 21, 1928.

'Taxpayer's records show that on September 24, 1928, she sold the 1,000 shares of Monitor Securities Corporation stock for cash to a Mr. I. R. Stewart, sale price $133,-333.33. As explained in the foregoing, the transaction was included for tax under Section 101 by the taxpayer.

'In accordance with a balance sheet of the United Mortgage Corporation showing the market value of its holdings as at September 20, 1928, the 1,000 shares of Monitor Securities Corporation was shown to have a market value of $133,333.33, which was confirmed by its sale by the taxpayer soon after receipt, September 24, 1928.

[fol. 38] 'It is the opinion of the examining officer that a taxable dividend is involved in the transaction for the following reason:

'By turning the 1,000 shares of Monitor Securities Corporation stock over to the Averill Corporation, the United Mortgage Corporation parted with a valuable asset. In turning its own entire capital stock over to the taxpayer, the Averill Corporation stock and the Monitor Securities Corporation stock became interchangeable insofar as the taxpayer was concerned, and in the final analysis served to reduce the Monitor Securities Corporation stock to possession and control of the taxpayer.

'Capital Net Gain

* * * * * * *

	Selling price of securities	Cost	Profit
As reported	$223,160.83	$125,557.40	$97,603.43
Decrease	133,333.33	57,325.45	76,007.88

'Decrease shown in the above represents respectively the selling price, cost and profit on 1,000 shares of Monitor Securities Corporation common stock. Whereas examining officer deemed the acquisition of this stock by the taxpayer to be in fact a dividend received in 1928 from the United Mortgage Corporation, as previously explained, having a market value of $133,333.33, subsequent sale price, the adjustment is made to eliminate the transaction from this schedule of the return.

'The cost of $57,325.45 used by the taxpayer in reporting the sale of the Monitor Securities Corporation stock was arrived at as follows:

[fol. 39] Cost of 5,000 shares of United Mortgage Corporation stock	$350,000.00
Market value, Sept. 20, 1928	814,064.25
Market value of 1,000 shares Monitor Securities Corporation stock included in the amount of $814,064.25 shown in the above	133,333.33
$133,333.33 equals 16.3787% of $814,064.25. 16.3787% of $350,000.00 equals	57,325.45

'The value of $814,064.25 used for United Mortgage Corporation stock was based upon the market value of its assets, consisting entirely of securities, verified by the examining officer and accepted as correct.

'Additional facts involved in this transaction were stated in the examining officer's letter of transmittal as follows:

'On the books of United Mortgage Corporation, the transaction was entered as a charge to surplus for $10,413.07 and a credit to the investment asset account "Monitor Securities Corporation" stock for $10,413.07, which closed out the latter account. The surplus affected was accoumulated after February 28, 1913.

• • • • • • •

'Other than the above mentioned deal, there were no other transactions by the Averill Corporation.

• • • • • • •

'Other than the corporate minute book, there were no books of account kept by the Averill Corporation, none being deemed necessary.'

[fol. 40] "The taxpayer in her protest states the facts, in substantial agreement with the examining officer's account. In addition, it was stated therein that at a meeting of the Board of Directors held on September 20, 1928

'the following minutes and resolutions were adopted:

"The Chairman stated that United Mortgage Corporation owned 1,000 shares of the capital stock of Monitor Securities Corporation; that it was desired to effect a reorganization whereby said stock of Monitor Securities Corporation should be held by Averill Corporation, a Delaware corporation, and that the stock of Averill Corporation should be issued in the names of the stockholders of United Mortgage Corporation as their interests respectively appear.

The following resolutions were thereupon adopted:

Resolved that H. F. Lippold, Vice-President of the Company, be and he hereby is authorized, empowered and directed to offer on behalf of this Corporation to Averill Corporation to transfer and deliver to said Averill Corpo-

ration 1,000 shares of the common stock of Monitor Securities Corporation and to cause said Averill Corporation, if it accepts such offer, to issue 500 shares of its capital stock in payment therefor, said shares to be issued in the names of the stockholders of this corporation as their interests respectively appear.'' '

[fol. 41] Supplemental Statement

''At the time of transfer of the 1,000 shares of Monitor stock by United Mortgage Corp. to Averill Corp., taxpayer owned the entire capital stock of United Mortgage Corp.

''The 1,000 shares of Monitor Securities Corp. were purchased by United Mortgage Corp., January 6, 1922 for $10,413.07. The entire capitalization of Monitor Securities Corporation, as a matter of relevant information, consists of 40,481 shares of common stock and 29,338 shares of preferred stock. It is, therefore, obvious that United Mortgage Corporation holdings of Monitor Securities Corp. stock had no significance with respect to any relationship of these two corporations, other than the fact that the 1,000 shares of stock represented one of the investment assets of United Mortgage Corp. This asset was carried on the books at cost, although available data showed the market value of this asset as of Sept. 20, 1928 to be $133,333.33.

''On the above noted date, namely, Sept. 20, 1928, an agreement was entered into between the United Mortgage Corp. and a newly organized corporation named Averill Corporation, in accordance with which the United Mortgage Corp. transferred to Averill Corp. the 1,000 shares of Monitor Securities Corp. stock, and in payment therefor the Averill Corporation turned its own entire capital stock over to the stockholders of United Mortgage Corp. as paid up and outstanding.

''The taxpayer, Evelyn F. Gregory, by virtue of owning the entire capital stock of United Mortgage Corp., received [fol. 42] the entire stock of the Averill Corp., which consisted of 500 shares of common stock having a par value of $100.00 a share.

''The transfer was affected Sept. 21, 1928.

''On the books of United Mortgage Corp., the transaction was entered as a charge to surplus for $10,413.07 and a credit to the investment asset account 'Monitor Securities

Corporation' stock for $10,413.07, which closed out the latter account. The surplus affected was accumulated after February 28, 1913.

"The Averill Corp. existed in entirety for a few days only, it being dissolved Sept. 24, 1928 (incorporated Sept. 18, 1928).

"Other than the above mentioned deal, there were no other transactions by the Averill Corp.

"Pursuant to its liquidation, and by virtue of her owning its entire capital stock, the Averill Corp. turned over to the taxpayer the 1,000 shares of Monitor Securities Corp.

"Other than the corporate minute book, there were no books of account kept by the Averill Corp., none being deemed necessary.

"On Sept. 24, 1928, taxpayer sold the 1,000 shares of Monitor Securities Corp., for $133,333.33, arrived at a cost by apportioning the cost of her investment in United Mortgage Corp. stock under the reorganization section, and reporting the profit thus arrived at as capital net gain in view of the acquisition of the 1,000 shares of Monitor Securities Corp. stock by United Mortgage Corp. back in 1922."

[fol. 43] STIPULATION AS TO CERTAIN FACTS

Thereupon the parties stipulated and agreed that the following facts were true, to wit: The taxpayer, Evelyn F. Gregory, acquired 3,300 shares of United Mortgage Corporation stock between October 1, 1920 and December 16, 1921, for a total cost of $180,000.00; and she acquired 1,700 shares of United Mortgage Corporation stock between the dates of January 12, 1927 and January 3, 1928, at a total cost of $170,000.00.

Thereupon HENRY F. LIPPOLD, having first been duly sworn as a witness on behalf of the taxpayer, testified as follows:

Direct examination:

"My name is Henry F. Lippold and I reside at 100 Rugby Road, Brooklyn, New York. I am acquainted with Evelyn F. Gregory, the petitioner in this case. I have known her for approximately 24 years, and I have had business rela-

tions with her largely since 1920. I was associated in business with George D. Gregory, her husband, and through that association I kept the books of Mrs. Gregory which included her check book. I drew all of the checks, attended to all financial matters, made out income tax returns, attended to sales of stocks and bonds, had access to her safe deposit boxes and had power of attorney on her main banking account. During the year 1928 I kept her books, made her income tax return for that year, had access to her safe deposit box, had power of attorney on her checking account, and supervised the financial transactions in which she was engaged. All purchases and sales of stock went through me [fol. 44] finally; but sometimes Mr. Gregory would tell me what transactions were to be put through. I had knowledge of all of the transactions.

"I am acquainted with the transaction in which United Mortgage Corporation transferred 1,000 shares of Monitor common stock to the Averill Corporation. I was President of the Averill Corporation. Also, in 1928 I was a director of the Monitor Corporation and I was Vice-president, Treasurer and Director of the United Mortgage Corporation. When the Averill Corporation transferred to Mrs. Gregory its entire capital stock consisting of 500 shares of the par value of $10 a share, in accordance with the reorganization plan and agreement with the United Mortgage Corporation, Mrs. Gregory did not surrender to United Mortgage Corporation any of her stock or securities. Mrs. Gregory still retains the entire 5,000 shares of United Mortgage Corporation stock; she has the same certificate that she got in the early part of 1928 when she bought the last block of minority stock.

"I am acquainted with the transaction by which Mrs. Gregory sold 1,000 shares of Monitor Securities Corporation stock. She sold that stock to I. R. Stewart at a price of $133,333.33 for the entire block of 1,000 shares.

"Mrs. Gregory reported her income for Federal tax purposes on the calendar year basis and also on the cash receipts and disbursement basis."

[fol. 45] Thereupon there was offered and received in evidence, as Petitioner's Exhibit 3, the income tax return of the taxpayer, Evelyn F. Gregory, for the year 1928. Said return states that the occupation of the taxpayer was that

of "housewife", and that her gross income, deductions, net income and capital gain were as follows:

Income

Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)	$1,484.88	
(a) Interest on tax-free Covenant Bonds upon which a tax was paid at source	1,097.93	
Dividends on Stock of Domestic Corporations	7,162.50	
Total Income		$9,745.31

Deductions

Tax paid	$482.88
Net Income	$9,262.43

Capital Net Gain

	Date acquired	Date sold	Amount received	Cost	Net gain or loss
Stocks & Bonds	1921-2-3	1928	$223,160.83	$125,557.40	$97,603.43

[fol. 46] Thereupon the witness continued to testify, on direct examination, as follows:

"I prepared and filed the income tax return of Mrs. Gregory for the year 1928. I made up that return from the books and records which I kept for her. The amount of capital gain, reported on the return in the amount of $97,603.43, includes a gain of $76,007.88 on the stock of the Averill Corporation and the sale of 1,000 shares of Monitor Securities Corporation; it also includes other gains. The amount of capital gain reported in excess of $76,007.88 relates to transactions not involved in this case."

On cross-examination the witness, Henry F. Lippold, testified as follows:

"By Mr. Corbin:

"Q. I believe you stated on direct examination that you are President of the Averill Corporation organized in 1928?

"A. That is right.

"Q. Could you tell me the purpose of the organization of the Averill Corporation?

"A. The entire transaction in the formation of Averill and its dissolution was carried out and supervised by counsel for Mrs. Gregory and on their advice.

"Board of Tax Appeals Member: The question is do you know the purpose?

"The Witness: At the time the possible opportunity to sell came along, the matter of income tax liability was discussed with Mrs. Gregory's counsel, and on their advice— [fol. 47] we were advised that we could effect a partial reorganization of the Monitor Securities Corporation by the formation of Averill Corporation and the turning over to Averill of 1,000 shares of Monitor stock, having the stock of Averill delivered direct to the stockholders of the United.

"The Member: Is it true that the purpose of the organization of the Averill was entirely to enable Mrs. Gregory to save income taxes which she might otherwise be required to pay if she carried through the transaction individually?

"The Witness: I do not see that there could be any other possible reason except to avail herself of the opportunity which the law and regulations afforded.

"By Mr. Corbin:

"Q. Did the Averill Corporation transact any other business?

"A. They did not."

Thereupon both the taxpayer and the Commissioner rested their cases.

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

(Signed) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue.

[fol. 48] The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, as attorney for the respondent on review.

George W. Saam, Attorney for Respondent on Review.

The foregoing is all of the material evidence adduced at the hearing and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this day of November, 1933.

——— ———, Member, United States Board of Tax Appeals.

ORDER APPROVING STATEMENT OF EVIDENCE

Approved and ordered filed this 23rd day of November, 1933.

(S.)J. M. Sternhagen, Member.

[fol. 49] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

PRÆCIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct of the following documents and records in the above entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board:
   (a) Petition, including annexed copy of deficiency letter.
   (b) Answer.
3. Opinion of the Board promulgated December 6, 1932.

[fol. 50] 4. Judgment or Decision of the Board entered January 26, 1933.

5. Order of the Board vacating judgment and substituting judgment, entered March 25, 1933.

6. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

7. Statement of the evidence as settled and allowed.
8. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.
9. This præcipe.

(Signed) B. Barrett Prettyman, General Counsel, Bureau of Internal Revenue.

Service of a copy of the within præcipe is hereby admitted this 22nd day of November, 1933.

(Sgd.) George W. Saam, Attorney for Respondent on Review.

No Counter præcipe will be filed.

George W. Saam.

[fol. 51] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 52] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1933

No. 324

Argued February 21, 1934. Decided March 19, 1934

GUY T. HELVERING, Commissioner of Internal Revenue, Appellant,

v.

EVELYN F. GREGORY, Appellee

Appeal from the United States Board of Tax Appeals

Before L. Hand, Swan, and Augustus N. Hand, Circuit Judges

Appeal by the Commissioner of Internal Revenue from an order of the Board of Tax Appeals, expunging a deficiency in income taxes.

Allin H. Pierce, of Washington, D. C., for appellant.

Hugh Satterlee, of Washington, D. C., for appellee.

L. HAND, Circuit Judge:

This is an appeal (petition to review), by the Commissioner of Internal Revenue from an order of the Board of Tax Appeals expunging a deficiency in income taxes for the year 1928. The facts were as follows: The taxpayer owned all the shares of the United Mortgage Corporation, among whose assets were some of the shares of another company, the Monitor Securities Corporation. In 1928 it became possible to sell the Monitor shares at a large profit, but if this had been done directly, the United Mortgage Corporation would have been obliged to pay a normal tax on the resulting gain, and the taxpayer, if she wished to touch her profit, must do so in the form of a dividend, on which a surtax would have been assessed against her personally. To reduce these taxes as much as possible, the following plan was conceived and put through: The taxpayer incorporated in Delaware a new company, organized ad hoc, and called the Averill Corporation, to which the United Mortgage Corporation transferred all its shares in the Monitor Securities Corporation, under an agreement by which the Averill Corporation issued all its shares to

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the taxpayer. Being so possessed of all the Averill shares, she wound up the Averill company three days later, receiving as a liquidating dividend the Monitor shares, which she thereupon sold. It is not disputed that all these steps were part of one purpose to reduce taxes, and that the Averill Corporation, which was in existence for only a few days, conducted no business and was intended to conduct none, except to act as conduit for the Monitor shares in the way we have described. The taxpayer's return for the year 1928 was made on the theory that the transfer of the Monitor shares to the Averill Corporation was a "reorganization" under section 112 (i) (1) (B) of the Revenue Act of 1928 (26 U. S. C. A. § 2112 (i) (1) (B), being "a transfer by a corporation of * * * a part of its assets to another corporation" in such circumstances that immediately thereafter "the transferor or its stockholders or both are in control of the corporation to which the assets are transferred." Since the transfer was a reorganization, she claimed to come within section 112 (g) of that act, 26 U. S. C. A. § 2112 (g), and that her "gain" should not be "recognized," because the Averill shares were "distributed, in pursuance of a plan of reorganization." The Monitor shares she asserted to have been received as a single liquidating dividend of the Averill Corporation, and that as such she was only taxable for them under section 115 (c), 26 U. S. C. A. § 2115 (c) and upon their value [fol. 53] less the cost properly allocated to the Averill shares. That cost she determined as that proportion of the original cost of her shares in the United Mortgage Corporation, which the Monitor shares bore to the whole assets of the United Mortgage Corporation. This difference she returned, and paid the tax calculated upon it. The Commissioner assessed a deficiency taxed upon the theory that the transfer of the Monitor shares to the Averill Corporation was not a true "reorganization" within section 112 (i) (1) (B), 26 U. S. C. A. § 2112 (i) (1) (B), being intended only to avoid taxes. He treated as nullities that transfer, the transfer of the Averill shares to the taxpayer, and the winding up of the Averill Corporation ending in the receipt by her of the Monitor shares; and he ruled that the whole transaction was merely the declaration of a dividend by the United Mortgage Corporation consisting of the Monitor shares in specie, on which the taxpayer must pay a surtax calculated at their full value. The taxpayer appealed and

the Board held that the Averill Corporation had been in fact organized and was indubitably a corporation, that the United Mortgage Corporation had with equal certainty transferred to it the Monitor shares, and that the taxpayer had got the Averill shares as part of the transaction. All these transactions being real, their purpose was irrelevant, and section 112 (i) (1) (B) was applicable, especially since it was part of a statute of such small mesh as the Revenue Act of 1928; the finer the reticulation, the less room for inference. The Board therefore expunged the deficiency, and the Commissioner appealed.

We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. U. S. v. Isham, 17 Wall. 496, 506, 21 L. Ed. 728; Bullen v. Wisconsin, 240 U. S. 625, 630, 36 S. Ct. 473, 60 L. Ed. 830. Therefore, if what was done here, was what was intended by section 112 (i) (1) (B), it is of no consequence that it was all an elaborate scheme to get rid of income taxes, as it certainly was. Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition. It is quite true, as the Board has very well said, that as the articulation of a statute increases, the room for interpretation must contract; but the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create. The purpose of the section is plain enough; men engaged in enterprises—industrial, commercial, financial, or any other—might wish to consolidate, or divide, to add to, or subtract from, their holdings. Such transactions were not to be considered as "realizing" any profit, because the collective interests still remained in solution. But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the share-

holders' taxes is not one of the transactions contemplated as corporate "reorganizations."

This accords both with the history of the section, and with its interpretation by the courts, though the exact point has not hitherto arisen. It first appeared in the Act of 1924 § 203, (h) (1) (B), 26 U. S. C. A. § 934 (h) (1) (B), and as the committee reports show (Senate Reports 398), was intended as supplementary to section 112 (g), 26 U. S. C. A. § 2112 (g), then section 203 (c), 26 U. S. C. A. § 934 (c); both in combination changed the law as laid down in U. S. v. Phellis, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180, and Rockefeller v. U. S., 257 U. S. 176, 42 S. Ct. 68, 66 L. Ed. 186. In the House Report (No. 179, 68th Congress 1st Sess.), and in the Senate Report (No. 398), the purpose was stated to be to exempt "from tax the gain from exchanges made in connection with a reorgaization in order that ordinary business transactions will not be prevented." Cf. Lonsdale v. Com'r, 32 F. (2d) 537, 539 (C. C. A. 8); Prairie O. & G. Co. v. Motter, 66 F. (2d) 309, 311 (C. C. A. 10). Moreover, we regard Pinellas Ice & Cold Storage Co. v. Com'r, 287 U. S. 462, 53 S. Ct. 257, 77 L. Ed. 428, and our own decision in Cortland Specialty Co. v. Com'r, 60 F. (2d) 937, as pertinent, if not authoritative. In each the question was of the applicability of a precursor of section 112 (i) (1) (A) of [fol. 54] 1928, 26 U. S. C. A. § 2112 (i) (1) (A), to the sale of all the assets of one company to another, which gave in exchange, cash and short time notes. The taxpayer's argument was that this was a "merger or consolidation," because the buyer acquired "all the property of another corporation," the seller, that being one statutory definition of "merger or consolidation." That assumed, the exemption was urged to fall within section 112 (g) as here. It might have been enough to hold that short time notes were not "securities," within section 112 (g); but both courts went further and declared that the transaction was not a "merger or consolidation," but a sale, though literally it fell within the words of section 112 (i) (1) (A). This they did, because its plain purpose was to cover only a situation in which after the transaction there continued some community of interest between the companies, other than the holding such notes. The violence done the literal interpretation of the words in no less than what we do here. Moreover, the act itself gives evidence that, on occasion anyway, the purpose of a transaction shouldl be the guide;

thus in section 115 (g), 26 U. S. C. A. § 2115 (f), the cancellation of shares is to be treated as a dividend—though otherwise it would not be such—if it is "essentially equivalent to the distribution of a taxable dividend"; again in section 112 (c) (2), 26 U. S. C. A. § 2112 (c) (2), a distribution is in part taxable as a dividend, if it "has the effect of the distribution of a taxable dividend."

We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a "reorganization," because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect. But the result is the same whether the tax be calculated as the Commissioner calculated it, or upon the value of the Averill shares as a dividend, and the only question that can arise is whether the deficiency must be expunged, though right in result, if it was computed by a method, partly wrong. Although this is argued with some warmth, it is plain that the taxpayer may not avoid her just taxes because the reasoning of the assessing officials has not been entirely our own.

Order reversed; deficiency assessed.

[fol. 55] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court-rooms in the Post Office building in the City of New York, on the 26th day of March one thousand nine hundred and thirty-four.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Augustus N. Hand, Circuit Judges.

38

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

EVELYN F. GREGORY, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 56] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Commissioner of Internal Revenue vs. Evelyn F. Gregory. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Mar. 26, 1934. William Parkin, Clerk.

[fol. 57] UNITED STATES OF AMERICA,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 56, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Commissioner of Internal Revenue, Petitioner, against Evelyn F. Gregory, Respondent, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 31st day of May, in the year of our Lord one thousand nine hundred and thirty-four, and of the Independence of the said United States the one hundred and fifty-eighth.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 58] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 38,755. U. S. Circuit Court of Appeals, Second Circuit, Term No. 127. Evelyn F. Gregory, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed June 23, 1934. File No. 127, O. T., 1934.

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FILE COPY

FILED

JUN 23 1934

CHARLES ELMORE CROPLEY
CLERK

No. 127

Supreme Court of the United States

OCTOBER TERM, 1934

EVELYN F. GREGORY,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

HUGH SATTERLEE,
Counsel for the Petitioner.

GEORGE W. SAAM,
ROLLIN BROWNE,
CHARLES A. ROBERTS,
Of Counsel.

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Supreme Court of the United States

OCTOBER TERM, 1934

No. _____

EVELYN F. GREGORY,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

May it please the Court:

Evelyn F. Gregory applies for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Second Circuit (R. 56), which reversed an order of the United States Board of Tax Appeals redetermining a deficiency in income tax for 1928 (R. 20), and respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF MATTER INVOLVED

In 1928 the petitioner owned all the stock of the United Mortgage Corporation, which held among its assets stock

of the Monitor Corporation. To facilitate a sale of the stock of the Monitor Corporation with the least burden of taxation the following plan was conceived and consummated:

A new corporation, the Averill Corporation, was organized. In exchange for the transfer to it by the United Corporation of stock in the Monitor Corporation, the Averill Corporation issued all of its stock, which was distributed to Mrs. Gregory, the sole stockholder of the United Corporation, without the surrender by her of her stock in the United Corporation. A few days later the Averill Corporation was dissolved and distributed the stock of the Monitor Corporation as a liquidating dividend to Mrs. Gregory, who thereupon sold such stock.

Giving effect to these transactions the petitioner maintained that the distribution to her of the Monitor stock by the Averill Corporation was a distribution in complete liquidation of the Averill Corporation, which was subject to tax in the amount and at the rate provided in the Revenue Act of 1928 with respect to liquidating distributions. The Commissioner of Internal Revenue determined that the petitioner received the Monitor stock as an ordinary dividend subject to tax in the amount and at the rate provided with respect to ordinary dividends. The Board of Tax Appeals sustained the petitioner's position. The Circuit Court of Appeals, disagreeing with both the Board and the Commissioner, held that the petitioner received the stock of the Averill Corporation (not of the Monitor Corporation) as an ordinary dividend from the United Corporation taxable at surtax rates, the resulting tax being the same in amount as that determined by the Commissioner. In so holding the Circuit Court of Appeals overruled the petitioner's contention, which had been upheld

by the Board of Tax Appeals, that the transfer of the Monitor stock to the Averill Corporation in exchange for the issuance of the stock of the Averill Corporation constituted a "reorganization" as defined in the statute.

The Revenue Act of 1928, with precise particularity and in identical language with the Revenue Acts of 1924, 1926, 1932 and 1934, in Section 112 (i) (1) (B) defines "reorganization" as a transfer by a corporation of a part of its assets to another corporation if immediately thereafter the transferor corporation or its stockholders or both are in control (that is, hold at least 80 per cent. of the stock) of the transferee corporation. In Section 112 (g) the Act permits the distribution free from tax of stock of a corporation "a party to a reorganization" as defined by the statute. It is clear that the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to the petitioner were not subject to tax if the language of the statute be accorded its ordinary meaning. In reaching the contrary conclusion the Circuit Court of Appeals reasoned that, although a purpose to avoid taxation does not vitiate a transaction, and the Averill Corporation had a juristic personality which could not be ignored, nevertheless "it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition."

The question presented, therefore, is:

Is a given transaction to be considered as falling within or without the statutory definition of reorganization, dependent on whether or not it was undertaken for the purpose of avoiding or reducing tax liability?

More specifically, is a transfer by a corporation of a part of its assets to another corporation, where immediately

after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, not a "reorganization" within the meaning of Section 112 (i) (1) (B) of the Revenue Act of 1928, if the purpose of the transaction is reduction of taxes?

B.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. It is not an exaggeration to say that the decision of the Circuit Court in this case is revolutionary. Ever since the first enactment in the Revenue Act of 1924, and the continuance in subsequent acts with minor changes, of elaborate, precise and comprehensive provisions governing the taxability of exchanges and reorganizations, taxpayers and their counsel, and until recently the Treasury Department, have acted and advised in reliance upon the plain propositions of the statute, regarding as non-taxable, transactions within the scope of the language given its ordinary significance, and regarding as taxable, transactions outside such scope, irrespective of motives and purposes whether of tax avoidance or otherwise. It made no difference, because the statute furnished its own definition, that many transactions within the statute were not reorganizations to a banker or to the man in the street or in the ordinary legal sense, which usually connotes the compulsion of financial difficulties.

But now, under the decision of the Circuit Court, the purpose of the transaction would become more important than what was actually done, and for the provisions of

the statute would be substituted the guess of each court in each case as to whether the ultimate object of the taxpayers was within the unexpressed intent of Congress. It is impossible for counsel to advise clients as to the effect of prospective transactions on their tax liability, or for clients safely to undertake readjustments of their affairs, when a strict compliance with the statutory provisions as they are written would be as likely to prove a trap as a refuge. No two courts could be counted on to agree on what were permissible purposes, once having abandoned the safe and sure ground of the statutory definition.

This is a question of enormous practical importance. Counsel have received numerous communications from lawyers in various parts of the country, all expressing amazement at the decision of the Circuit Court and urging application for a writ of certiorari. This wide concern is not strange when it is recalled that thousands of reorganizations, just now coming before the courts for consideration, were consummated in the late 1920's in reliance on what was regarded as the unambiguous language of the statute and on the administrative acquiescence in such interpretation. In the reversal of the position of the Treasury Department so late in the day, and in the pronouncement of a novel decision such as that of the Circuit Court of Appeals in this case, taxpayers feel bewildered and unable with any certainty to estimate their tax liability whether in respect of reorganizations which they had undertaken with full assurance of their conformity with the statute or in respect of prospective reorganizations now in contemplation.

2. The Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable de-

cisions of this Court. It has often been held that the words of a statute should be taken in their plain popular meaning, and that unambiguous language permits no resort to extraneous considerations. *Woolford Realty Co.* v. *Rose,* 286 U. S. 319; *United States* v. *Kirby Lumber Co.,* 284 U. S. 1, 3; *Crooks* v. *Harrelson,* 282 U. S. 55. Where a statute has had a consistent practical construction, and Congress has repeatedly re-enacted the same language, the conclusion is required that such construction was not inconsistent with the intent of the statute. *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U. S. 269; *Old Colony R. R. Co.* v. *Commissioner,* 284 U. S. 552; *Poe* v. *Sanborn,* 282 U. S. 101; *Wisconsin* v. *Illinois,* 278 U. S. 367, 413. A purpose to avoid taxes is immaterial. *Superior Oil Co.* v. *United States,* 280 U. S. 390; *Bullen* v. *Wisconsin,* 240 U. S. 625; *United States* v. *Phellis,* 257 U. S. 156.

The precise point of the construction of Section 112 (i) (1) (B) of the Revenue Act of 1928, embodying a definition of "reorganization", has not heretofore been presented to this Court, but it has had occasion in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, to consider the disjunctive definition of "reorganization" in Section 112 (i) (1) (A) of the 1928 Act. In that case the Court disapproved the construction of the Circuit Court of Appeals for the Fifth Circuit as not giving effect to all of the words in the definition, and as conflicting with the established practice of the tax officers and likely to produce perplexity.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and de-

termination on a day certain to be therein named a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 13,158, *Guy T. Helvering, Commissioner of Internal Revenue, Appellant* v. *Evelyn F. Gregory, Appellee*", and that said judgment of the Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

June 25, 1934.

EVELYN F. GREGORY,
by HUGH SATTERLEE,
Counsel for the Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF COURTS BELOW

The opinion in the United States Board of Tax Appeals is reported in *Evelyn F. Gregory* v. *Commissioner of Internal Revenue,* 27 B. T. A. 223 (R. 14); and the opinion of the Circuit Court of Appeals for the Second Circuit, rendered March 19, 1934, is reported in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Evelyn F. Gregory,* 69 Fed. (2d) 809 (R. 52).

II.

JURISDICTION

This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stats. 938. See *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716. The date of the judgment sought to be reviewed is March 26, 1934 (R. 56).

III.

STATEMENT OF CASE

By 1928 the petitioner, Mrs. Gregory, had acquired all the stock of United Mortgage Corporation (R. 22, 30).

On September 18, 1928, Averill Corporation was organized, and on September 21, 1928, pursuant to a plan of reorganization or readjustment, United Mortgage Corporation transferred a part of its assets, consisting of stock in the Monitor Securities Corporation, to Averill Corpora-

tion in exchange for the issue by Averill Corporation of all of its stock, which was distributed to Mrs. Gregory, the holder of all the stock of United Mortgage Corporation, without the surrender by her of her stock in United Mortgage Corporation (R. 22, 31, 32).

On or about September 24, 1928, Averill Corporation was dissolved and distributed in liquidation to Mrs. Gregory, the holder of all of its stock, all of its assets, consisting of stock in the Monitor Corporation. Immediately thereafter Mrs. Gregory sold the stock of the Monitor Corporation (R. 22, 23, 32).

Mrs. Gregory reported a capital gain on the distribution in liquidation to her of the stock in the Monitor Corporation. The Commissioner of Internal Revenue determined, in lieu thereof, that she received an ordinary dividend upon the distribution to her of the Monitor stock. The Board of Tax Appeals held that Mrs. Gregory realized a capital gain upon the distribution in liquidation of the Monitor stock, and not an ordinary dividend (R. 23). The Circuit Court of Appeals held that Mrs. Gregory received a taxable dividend upon the distribution to her of the stock of Averill Corporation, and neither a capital gain nor a taxable dividend upon the distribution to her of the Monitor stock (R. 52).

IV.

SPECIFICATION OF ERRORS

1. The Circuit Court of Appeals erred in holding that the distribution to Mrs. Gregory of the stock of Averill Corporation, without the surrender by her of her stock of the United Mortgage Corporation, constituted a taxable dividend.

2. The Circuit Court of Appeals erred in holding that the transfer by United Mortgage Corporation of a part of its assets to Averill Corporation, in exchange for the issue of all the stock of Averill Corporation, was not a reorganization within the definition of reorganization in Section 112 (i) (1) (B) of the Revenue Act of 1928.

3. The Circuit Court of Appeals erred in refusing to give effect to the plain language of the statute and its specific definition of reorganization because of the assumption that Congress did not mean to cover a business transaction undertaken to reduce taxes on the disposition of an investment.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals, which was supported by the findings of fact.

V.

ARGUMENT

A. No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation without the surrender by her of the stock of United Mortgage Corporation; for

B. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the definition of the statute; and

C. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was no less a reorganization because the purpose was to minimize taxes.

A.

No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation without the surrender by her of the stock of United Mortgage Corporation.

The distribution of the stock of Averill Corporation to Mrs. Gregory was in pursuance of a plan by which part of the assets of the United Mortgage Corporation, consisting of stock of the Monitor Corporation, was segregated in a separate corporation, to wit, Averill Corporation, controlled by Mrs. Gregory. Section 112 (g) of the Revenue Act of 1928 provides:

> "(g) **Distribution of stock on reorganization.**—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

If, then, the transfer of part of the assets of United Mortgage Corporation to the Averill Corporation was a reorganization within the definition of the statute, there was distributed in pursuance of the plan of reorganization to Mrs. Gregory, the sole stockholder of United Mortgage Corporation, a party to the reorganization, stock of Averill Corporation, also a party to the reorganization, without the surrender by Mrs. Gregory of her stock in the United Mortgage Corporation; and therefore no gain to Mrs. Gregory from the receipt of such stock of Averill Corporation was recognizable.

There is no dispute about the validity of this conclu-

tion, assuming the existence of a reorganization. The only issue raised by the opinion of the Circuit Court of Appeals is whether or not there was a reorganization within the definition of the statute.

B.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the definition of the statute.

Section 112 (i) (1) (B) of the Revenue Act of 1928 provides:

> "(i) **Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term 'reorganization' means * * * (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred", * * *.

Here there was a transfer by United Mortgage Corporation of a part of its assets, consisting of stock of the Monitor Corporation, to another corporation, namely, Averill Corporation, and immediately after the transfer the transferor, that is, United Mortgage Corporation, or its stockholders, comprising Mrs. Gregory, or both, were in control of the corporation, that is, Averill Corporation, to which the assets were transferred. "Control" under Section 112 (j) means the ownership of at least 80 per cent. of the stock of a corporation.

The precise transaction contemplated by the statute,

the segregation of part of the assets of a corporation in another corporation, with immediate control of the second corporation in the first corporation or its stockholders, was undertaken and accomplished here. No more complete conformity with the statutory definition could possibly be imagined. No element or factor was lacking: what was accomplished was exactly what the statute said and meant, unless the plainest possible language may be ignored.

C.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was no less a reorganization because the purpose was to minimize taxes.

The Circuit Court expressed itself as in agreement with the Board of Tax Appeals and the taxpayer that a transaction does not lose its immunity from tax because it is actuated by a desire to avoid taxation, and that anyone may so arrange his affairs that his taxes shall be as low as possible. The Circuit Court also agreed, in disagreement with the Commissioner, that it could not treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by Averill Corporation of its own shares to Mrs. Gregory, and her acquisition of the Monitor shares by winding up Averill Corporation, and that all these steps were real. In short it affirmed, as has so often been recognized by the courts, that a purpose to minimize taxes is immaterial and constitutes no warrant for ignoring corporate entity.

Having rendered lip service to these fundamental principles, however, the Circuit Court jumped to the conclusion

that Congress did not mean to cover by its definition of reorganization a transaction which was entered into for the purpose of minimizing taxes. To counsel it seems that the Court stultified its previous declaration of principles and in effect decided that the purpose of a transaction, and not what was actually done, determines its taxability.

At any rate, the result is to make meaningless the language of the statute and to relegate to the courts to decide in every case what is the controlling motive of a transaction and just where is the line of demarcation between two transactions which equally conform with the language of the statute, but which may be carried out with differing objects in view. It is an impossible situation from the standpoint of tax administration, and from the standpoint of taxpayers, who are entitled to know in advance whether or not a transaction is likely to involve them in burdensome taxation.

Suppose Mrs. Gregory, instead of dissolving Averill Corporation almost immediately after receipt of its stock, had kept it in existence for a year or so as a holding corporation separate from United Mortgage Corporation. The Commissioner, who did not determine any profit upon the distribution to her of the Averill stock, would obviously never have questioned the transaction, nor would anyone else have had the slightest doubt that it was a statutory reorganization. Suppose, instead of dissolving Averill Corporation, Mrs. Gregory had almost immediately sold its stock to strangers, which would have resulted in the same taxable profit actually reported by her. It is extremely unlikely that the consummation of the transaction in that form would ever have been questioned, because, as already noted, the Commissioner did not assert any gain on the distribution to Mrs. Gregory of the Averill stock. Yet in

these illustrative and typical variations it may be assumed that the purpose of the transaction was to minimize taxes. Where is the line to be drawn?

The Circuit Court indicates reliance on the history of the reorganization provisions. In the 1913, 1916 and 1917 Acts there were none. In the 1918 Act, in Section 202 (b), there first occurred a meager and general provision. In the 1921 Act, in Section 202, the reorganization provisions were somewhat amplified, but still were not explicit. In the 1924 Act, as a result of a conscious choice between the policy of a broad, general provision as to reorganizations, with the Treasury Department formulating regulations to cover the various species of reorganizations, and the policy of comprehensively covering the entire field by meticulously specific provisions, the latter course was adopted, and the elaborate provisions first enacted in Section 203 of the 1924 Act have been retained with minor changes in the 1926, 1928, 1932 and 1934 Acts. These reorganization provisions so far as material to the issue in this case are set forth in an appendix hereto.

The definition of reorganization with which we are concerned has remained unchanged for ten years in the successive statutes, including the 1934 Act, and thousands of reorganizations have been carried out under its terms with never a question having been raised, until the consideration of this case in the Circuit Court of Appeals, that a reorganization was not a reorganization if undertaken with the purpose of minimizing taxes. The applicable regulations of the Treasury Department, which are set forth in the appendix hereto, take no diverse view. After this decade of statutory reenactment without change, and of the practical construction of the statute both by the Treasury Department and by taxpayers, it is late in the

day to deprive a taxpayer of the benefit of the statute on the ground that Congress did not mean what it said.

The reorganization provisions are based on the realization that a corporate readjustment, when the ultimate interest of the stockholders in the assets remains substantially the same, does not as a practical matter and in essence give rise to gain or loss. If, then, the splitting up of the assets of one corporation between two corporations, where the stockholders of the first corporation also become the stockholders of the second corporation (so that the stockholders have the same ultimate interest in the same assets through holding stock in two corporations instead of one), does not result in recognizable gain or loss, the purpose of the readjustment is irrelevant. (See Appendix F.)

The Circuit Court quotes a Congressional report to the effect that the reorganization provisions were intended to exempt "from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented." The Court failed to observe that the "ordinary business transaction" here in question was the disposition of the Monitor stock. The earlier revenue acts had impeded capital transactions by subjecting the gain therefrom to progressively high rates like ordinary income. As a remedial measure, to encourage the free flow of capital, Congress finally provided for postponed taxation and lower rates wherever the taxpayer could bring his transactions within the prescribed categories of reorganizations and exchanges. We submit that the Court was mistaken in thinking that Congress did not intend to cover such a situation or that there is any inherent injustice in permitting the taxpayer to split her investment in corporate stock, apply an allocated

part of its cost in computing gain from the sale of a segregated portion of the investment, and receive the benefit of the special rate of taxation provided for capital gains.

The Circuit Court attempts to support its decision by reference to the decision of this Court in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, and to its own decision in *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937, saying that in those cases "the violence done the literal interpretation of the words is no less than what we do here". The situations are scarcely comparable. The *Pinellas* and *Cortland* cases were concerned with the definition of reorganization in Section 112 (i) (1) (A), which provides that the term "reorganization" means "(A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)," as may be seen by reference to the complete text of the paragraph set out in the appendix hereto. In the *Pinellas* case the Circuit Court of Appeals for the Fifth Circuit had assumed that Congress intended to use the words "merger" and "consolidation" in their ordinary and accepted meanings, and that giving the matter the most liberal construction it was only when there was an acquisition of substantially all of the property of another corporation in connection with a merger or a consolidation that a reorganization took place. This Court thought the construction of the Circuit Court of Appeals too narrow, noting that it conflicted with the established practice of the tax officers and might produce perplexity, and insisted that all the words in the definition be given effect.

In both the *Pinellas* and *Cortland Specialty* cases there was a sale for promissory notes, with no retention of control, and accordingly nothing resembling a merger or consolidation. The definition in clause (B), with which we are concerned, does not embody the words "merger or consolidation", but on the contrary makes perfectly plain that, as opposed to the combination of corporations or their assets contemplated by clause (A), clause (B) contemplates the segregation of corporations or their assets. The *Pinellas* and *Cortland* decisions adopted a logical interpretation of clause (A), but their reasoning has no application to clause (B) except as the opinion in the *Pinellas* case emphasizes that the words of the statute may not be disregarded.

No other decision of any court, no decision of the Board of Tax Appeals, and no published ruling of the Treasury Department, has ever to the knowledge of counsel denied effectiveness as a reorganization to the transfer by one corporation of a part of its assets to another corporation in exchange for its stock, where immediately after the transaction the first corporation or its stockholders or both have been in control of the second corporation through the ownership of at least 80 per cent. of its stock, regardless of the motives actuating the participants in the transactions or the purposes which they sought to achieve. The decision of the Circuit Court of Appeals has disregarded all precedent and practice, and has created confusion with respect both to prospective reorganizations and to past reorganizations. So long as this decision stands utter uncertainty will have replaced reasonable certainty.

As regards a host of consummated transactions, in respect of many of which the statute of limitations has already barred the Government from attempting to assert

its view of the *ratio decidendi* of the present case, the taxpayers will be encouraged, in connection with future sales of property involved in such doubtful reorganizations, to claim stepped-up bases for ascertaining gain or loss, as against using the cost to their transferors to which they would be restricted in reorganizations in which no gain was recognized. In short, it would be difficult to conceive a decision involving tax law which would be more certain to breed litigation, ultimately beneficial neither to the Government nor to taxpayers.

Conclusion.

It is accordingly respectfully submitted that this case calls for the exercise by this Court of its supervisory powers in order that the manifest errors of the Circuit Court of Appeals may be corrected, and that to such end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals and finally reverse it.

June 25, 1934.

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APPENDIX

A.

Revenue Act of 1918, Section 202 (b)

"SEC. 202. . . . . .

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger, or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

B.

Revenue Act of 1921, Section 202 (c)

"SEC. 202. . . . . .

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such prop-

erty, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized— . . .

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization", as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);" . . .

C.

Revenue Act of 1924, Section 203 (b) (c) (g) (h) (i)

Revenue Act of 1926, Section 203 (b) (c) (g) (h) (i)

Revenue Act of 1928, Section 112 (b) (g) (h) (i) (j)

Revenue Act of 1932, Section 112 (b) (g) (h) (i) (j)

The matter in italics below appears only in the provisions of the 1924 and 1926 Acts, which are identical.

The matter in brackets appears only in the provisions of the 1928 and 1932 Acts, which are identical except for the addition in the 1932 Act of the matter in small capitals.

Except for the new matter in the 1932 Act, the actual text of the provisions is the same in all four Acts.

"[SEC. 112] *Sec. 203.* . . .

(b) **[Exchanges solely in kind.—]** . . .

[(3) STOCK FOR STOCK ON REORGANIZATION.—] (*2*) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

[(4) SAME—GAIN OF CORPORATION.—] (*3*) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. . . .

[(g) Distribution of stock on reorganization.—] *(c)* If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

[(h) Same—effect on future distributions.—] *(g)* The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, IF NO GAIN TO THE DISTRIBUTEE FROM THE RECEIPT OF SUCH STOCK OR SECURITIES WAS RECOGNIZED BY LAW, shall not be considered a distribution of earnings or profits within the meaning of [section 115 (b)] *subdivision (b) of section 201* for the pur-

pose of determining the taxability of subsequent distributions by the corporation.

[(i) Definition of reorganization.—] *(h)* As used in this section and sections [113 and 115] *201 and 204*—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

[(j) Definition of control.—] *(i)* As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

D.

Revenue Act of 1934, Section 112

Section 112 (a)-(f) of the 1934 Act is identical with Section 112 (a)-(f) of the 1928 and 1932 Acts. Section 112 (g) of the 1928 and 1932 Acts is omitted in the 1934

Act; Section 112 (h), limited to apply only to years prior to 1934, appears as Section 115 (h) of the 1934 Act; and Section 112 (j) and (k) becomes Section 112 (h) and (i) in the 1934 Act. Section 112 (i) of the 1928 and 1932 Acts is modified in the 1934 Act to read as follows:

"(g) DEFINITION OF REORGANIZATION.—As used in this section and section 113—

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

E.

Regulations 74

The following regulations, similar to the corresponding articles of the regulations under the 1924, 1926 and 1932 Acts (no regulations having yet been promulgated under the 1934 Act), were issued by the Treasury Department for the administration of such provisions of Section 112 of the Revenue Act of 1928 as are here material:

"ART. 574. **Exchanges in connection with corporate reorganizations.**—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. If two or more corporations reorganize, for example, by—

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or

(4) The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation—then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.) . . .

ART. 576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

ART. 577. **Definitions.**—The term "reorganization," as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent. of the voting stock, and

(2) At least 80 per cent. of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

ART. 578. **Source of distribution of stock or securities.**—The general rule, provided in section 115 (b), that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to a distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or of stock or securities in a corporation a party to the reorganization. Such a distribution will not be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, which are available for distribution and which under section 115 (b) must be distributed before earnings and profits accumulated before March 1, 1913, may be distributed exempt from tax.

Example: The X Corporation has a capital of $100,000, earnings and profits accumulated prior to March 1, 1913, of $25,000, and earnings and profits of $50,000 accumulated after February 28, 1913. It causes the organization of the Y Corporation, to which it transfers $50,000 of its assets in exchange for all of the stock of the Y Corporation. It then distributes the stock of the Y Corporation as a dividend to its shareholders. No gain to the shareholders from the receipt of this stock will be recognized under the provisions of section 112 (g) and article 576, nor will the distribution be considered a distribution of earnings or profits in determining the amount of earn-

ings and profits accumulated since February 28, 1913, on hand for subsequent distribution as a dividend.

The provisions of this article apply to the case in which the X Corporation distributes the stock of the Y Corporation as a dividend, the case in which the X Corporation distributes the stock of the Y Corporation in retirement of a portion of the stock of the X Corporation, and the case in which the Y Corporation issues its stock direct to the shareholders of the X Corporation."

F.

Statement in Report No. 398 of Committee on Finance of Senate on Revenue Bill of 1924

(The same statement appears in Report No. 179 of the Committee on Ways and Means of the House (page 17), and in the statement of January 5, 1924, issued by A. W. Gregg, Special Assistant to the Secretary of the Treasury, who was largely responsible for drafting the reorganization provisions in the Revenue Act of 1924.)

"SECTION 203 (h): (1) Subdivision (h) (1) contains a definition of reorganization which corresponds to the definition contained in section 202 (c) (2) of the existing law. The only change in the definition is to include within its terms the case of a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders, or both, are in control of the corporation to which the assets are transferred. This is a common type of reorganization, and clearly should be included within the reorganization provisions of the statute."

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CHARLES ELM

Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY,
Petitioner,
v.
GUY T. HELVERING, Commissioner of Internal Revenue.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER

HUGH SATTERLEE,
Counsel for the Petitioner.

GEORGE W. SAAM,
ROLLIN BROWNE,
CHARLES A. ROBERTS,
Of Counsel.

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OPINIONS BELOW

The opinion in the United States Board of Tax Appeals is reported in *Evelyn F. Gregory* v. *Commissioner of Internal Revenue,* 27 B. T. A. 223 (R. 8); and the opinion of the Circuit Court of Appeals for the Second Circuit is reported in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Evelyn F. Gregory,* 69 Fed. (2d) 809 (R. 33).

JURISDICTION

This Court has jurisdiction to review the judgment below under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stats. 938. See *Old*

Colony Trust Co. v. *Commissioner*, 279 U. S. 716. The date of the judgment sought to be reviewed is March 26, 1934 (R. 37).

QUESTION PRESENTED

Is a given transaction to be considered as falling within or without the statutory definition of reorganization, dependent on whether or not it was undertaken with the motive of minimizing tax liability?

More specifically, is a transfer by a corporation of a part of its assets to another corporation in exchange for all of its stock, so that immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, not a "reorganization" within the meaning of Section 112 (i) (1) (B) of the Revenue Act of 1928, if the purpose of the transaction is to pay the minimum tax and the transferee corporation is shortly dissolved?

STATUTE INVOLVED

The statute directly involved is Section 112 (i) (1) (B) and (j) of the Revenue Act of 1928 (45 Stat. 791, 818, c. 852) as follows:

> **(i) Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term "reorganization" means . . . (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, . . .
>
> **(j) Definition of control.**—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Collateral provisions of the statute are set forth in the appendix hereto (p. 54).

STATEMENT OF CASE

The petitioner had owned for seven years 66 per cent. and for a less period 100 per cent. of the stock of an investment company (R. 18-20). Her cost for the stock was about 43.6 per cent. of its present value. An asset representing one-sixth of the net worth of the company could be sold advantageously and her investment liquidated proportionately, provided the expense of the sale, including taxes, were not excessive. If the company should sell the asset and distribute the proceeds to her, there would be taxes on both of them. If the company should distribute the asset to her as an ordinary dividend and she should sell it, she would be subject to surtax on its entire value. Evidently, if she was to be presently subject to tax only on the profit realized by the liquidation of one-sixth of her investment, any tax on the unrealized profit on the remaining five-sixths being deferred until it should be realized by liquidation or sale, it was necessary to segregate that portion of her investment represented by the asset in question before its sale. The opinion of the Board of Tax Appeals states what was done, as follows (R. 9):

> "The petitioner was the owner of all the outstanding (5,000) shares of the United Mortgage Corporation. Of these, 3,300 shares had been purchased between October 1, 1920, and December 16, 1921, at a cost of $180,000, and 1,700 shares between January 12, 1927, and January 3, 1928, at a cost of $170,000. The United corporation had among its assets 1,000 shares of the Monitor Securities Corporation. On September 18, 1928, the Averill corporation was organized under Delaware law. On September 20, 1928, the United corporation transferred to the Averill corpo-

ration the 1,000 shares of Monitor stock, in consideration for which the Averill corporation issued its shares to the petitioner. On September 24, 1928, the Averill corporation liquidated and dissolved, thus distributing its entire assets, consisting of the Monitor shares, to its only shareholder, the petitioner. On the same date as the liquidation distribution, petitioner sold the Monitor shares for $133,333.33.

In her return, she treated these several transactions as governed by the several reorganization provisions of the statute, and returned as capital net gain derived from the sale price of $133,333.33 the amount of $76,007.88 upon an apportioned cost basis of $57,325.45.

None of the foregoing facts or figures is in dispute, the respondent conceding that, if the petitioner was legally correct in applying the reorganization provisions of the statute to the situation, her computation of gain is correct."

Maintaining that the distribution to her of the Averill stock was pursuant to a reorganization, from which no taxable gain was recognizable, the petitioner computed and reported a capital gain of $76,007.88 upon the distribution to her of the Monitor stock on complete liquidation of the Averill Corporation, as follows (R. 23):

Value United Corporation net assets		$814,064.25
Value Monitor stock included therein		133,333,33
Proportion value Monitor stock to all assets		16.3787%
Proportion value other assets to all assets		83.6213%
Cost to petitioner of United stock		350,000.00
Apportioned cost of old and new stock:		
Averill stock 16.3787% of $350,000		57,325.45
United stock 83.6213% of $350,000		292,674.55
Distribution Monitor stock on Averill dissolution:		
Value Monitor stock	$133,333.33	
Less cost Averill stock	57,325.45	
Gain		$76,007.88

As $57,325.45 of the cost of the United Corporation stock was apportioned to the Averill stock, the petitioner's basis for the United stock upon a subsequent liquidation or sale was reduced by the same amount. The full amount of $133,333.33 having been taken into account in computing the gain on the liquidation of Averill Corporation, no further profit resulted from the subsequent sale of the Monitor stock at the same figure.

The Commissioner of Internal Revenue, disregarding the existence of the Averill Corporation, determined that the petitioner received the Monitor stock as an ordinary dividend from the United Corporation, subject to surtax at the full value of $133,333.33, without any deduction of cost. The Board of Tax Appeals sustained the petitioner's position, on the ground that the Averill Corporation could not be disregarded and accordingly that there was a statutory reorganization "and hence no gain to the petitioner as distributee from the United Corporation of the Averill shares." (R. 9, 11.) The Circuit Court of Appeals, disagreeing with both the Board and the Commissioner, held that the petitioner received the stock of the Averill Corporation (not of the Monitor Corporation) as an ordinary dividend from the United Corporation, taxable at surtax rates, the resulting tax being the same in amount as that determined by the Commissioner. In so holding the Circuit Court of Appeals rejected the petitioner's contention, which had been upheld by the Board of Tax Appeals, that the transfer of the Monitor stock to the Averill Corporation in exchange for the issuance of the stock of the Averill Corporation constituted a "reorganization" as defined in the statute.

SUMMARY OF ARGUMENT

Section 112 (i) (1) (B) of the Revenue Act of 1928, with precise particularity and in identical language with the Revenue Acts of 1924, 1926, 1932 and 1934, defines "reorganization" as a transfer by a corporation of a part of its assets to another corporation if immediately thereafter the transferor corporation or its stockholders or both are in control (that is, hold at least 80 per cent. of the stock) of the transferee corporation. In Section 112 (g) (Appendix, p. 54) the Act permits the distribution free from tax of stock of a corporation "a party to a reorganization" as defined by the statute. It is clear that the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to the petitioner were not subject to tax if the language of the statutory definition of reorganization be accorded its ordinary meaning. In reaching its conclusion that there was not a "reorganization", the Circuit Court of Appeals reasoned that, although a purpose to avoid taxation does not vitiate a transaction, and the Averill Corporation had a juristic personality which could not be ignored, nevertheless "it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition."

The Circuit Court of Appeals erred in holding that the distribution to Mrs. Gregory of the stock of Averill Corporation constituted a taxable dividend, despite the provisions of Section 112 (g) of the 1928 Act; it erred in holding that the transfer by United Mortgage Corporation of a part of its assets to Averill Corporation, in exchange for the issue of all the stock of Averill Corporation, was not a reorganization within the definition of "reorganization" in Section 112 (i) (1) (B) of the 1928

Act; it erred in refusing to give effect to the plain language of the statute and its specific definition of reorganization upon the assumption that Congress intended to exclude a business transaction undertaken to minimize taxes on the disposition of an investment.

The petitioner accordingly maintains the following propositions:

I. No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation, pursuant to a reorganization, without the surrender by her of the stock of United Mortgage Corporation; but gain was recognizable on the distribution to her of the Monitor stock upon complete liquidation of Averill Corporation; for

II. The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the express definition of the statute;

III. Such transfer was a reorganization within the intent of Congress; for

A. The intent of Congress to defer recognition of gain in formal intercorporate readjustments is indicated by the history of the reorganization provisions of the revenue acts;

B. Congress did not intend that reorganizations be judged by the motives inducing them;

C. Nevertheless the disposition of investments with the greatest ultimate profit is a reason germane to the conduct of business; and

D. When Congress has intended the purpose of a transaction to control it has expressly so provided;

IV. Such transfer was a reorganization within the regulations and rulings of the Treasury Department; and

V. Such transfer was a reorganization within the decisions of the Courts.

In conclusion, the decision of the Board of Tax Appeals was correct and that of the Circuit Court of Appeals was erroneous.

ARGUMENT

I.

No gain was recognizable to Mrs. Gregory on the distribution to her of all the stock of Averill Corporation, pursuant to a reorganization, without the surrender by her of the stock of United Mortgage Corporation; but gain was recognizable on the distribution to her of the Monitor stock upon complete liquidation of Averill Corporation.

In 1928 the petitioner owned all the stock of the United Mortgage Corporation, which held among its assets stock of the Monitor Corporation. A new corporation, the Averill Corporation, was organized. In exchange for the transfer to it by the United Corporation of stock in the Monitor Corporation, the Averill Corporation issued all of its stock, which was distributed to Mrs. Gregory, the sole stockholder of the United Corporation, without the surrender by her of her stock in the United Corporation, so that she then held all the stock of both the United Corporation and the Averill Corporation, which together owned the same property previously owned by the United Corporation. A few days later the Averill Corporation was dissolved and distributed the stock of the Monitor Corporation as a liquidating dividend to Mrs. Gregory, who thereupon sold such stock.

The distribution of the stock of Averill Corporation to Mrs. Gregory was in pursuance of a plan by which part of the assets of the United Mortgage Corporation, consisting of stock of the Monitor Corporation, was segregated in a separate corporation, to wit, Averill Corporation, controlled by Mrs. Gregory. Section 112 (g) of the Revnue Act of 1928 provides:

> "(g) **Distribution of stock on reorganization.**—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

If, then, the transfer of part of the assets of United Mortgage Corporation to the Averill Corporation was a reorganization within the definition of the statute, there was distributed in pursuance of the plan of reorganization to Mrs. Gregory, the sole stockholder of United Mortgage Corporation, a party to the reorganization, stock of Averill Corporation, also a party to the reorganization, without the surrender by Mrs. Gregory of her stock in the United Mortgage Corporation; and therefore no gain to Mrs. Gregory from the receipt of such stock of Averill Corporation was recognizable.

There is no dispute about the validity of this conclusion, assuming the existence of a reorganization. The only issue raised by the opinion of the Circuit Court of Appeals is whether or not there was a reorganization within the definition of the statute.

However, when the Averill Corporation was dissolved and its property, consisting of the Monitor stock, was dis-

tributed in liquidation to Mrs. Gregory as the sole stockholder, she realized a gain under Section 115 (c) of the 1928 Act (Appendix, p. 56), providing "that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock". Such gain, pursuant to Section 111 (a) of the 1928 Act (Appendix, p. 54), was measured by the excess of the then market value of the Monitor stock over the basis to Mrs. Gregory of the stock of Averill Corporation, computed by apportioning her cost for the stock of the United Corporation between the stock of the United Corporation and the stock of Averill Corporation, pursuant to Section 113 (a) (9) of the 1928 Act (Appendix, p. 56). This method of determining her taxable gain was followed by Mrs. Gregory in her return, in accordance with Articles 600 and 625 of Regulations 74 of the Treasury Department.

The Board of Tax Appeals found that Mrs. Gregory had reported all the profit and paid all the tax attributable to the transactions that actually took place. The respondent and the Circuit Court would impose an additional tax in violation of the express provisions of the statute.

II.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the express definition of the statute.

Section 112 (i) (1) (B) of the Revenue Act of 1928 provides:

> "(i) **Definition of reorganization.**—As used in this section and sections 113 and 115—
>
> (1) The term 'reorganization' means . . . (B)

> a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred", . . .

Here there was a transfer by United Mortgage Corporation of a part of its assets, consisting of stock of the Monitor Corporation, to another corporation, namely, Averill Corporation, and immediately after the transfer the transferor, that is, United Mortgage Corporation, or its stockholders, comprising Mrs. Gregory, or both, were in control of the corporation, that is, Averill Corporation, to which the assets were transferred. "Control" under Section 112 (j) means the ownership of at least 80 per cent. of the stock of a corporation.

The precise transaction contemplated by the statute, the segregation of part of the assets of a corporation in another corporation, with immediate control of the second corporation in the first corporation or its stockholders, was undertaken and accomplished here. No more complete conformity with the statutory definition could possibly be imagined. No element or factor was lacking: what was accomplished was exactly what the statute said and meant, unless the plainest possible language may be ignored.

It is a cardinal principle that the words of a statute, if plain, are the sole measure of its scope and application. The rule was stated in *Adams Express Company* v. *Kentucky,* 238 U. S. 190, 199, as follows:

> "It is elementary that the first resort, with a view to ascertaining the meaning of a statute, is to the language used. If that is plain there is an end to construction, and the statute is to be taken to mean what it says."

United States v. *Shreveport Grain & Elevator Company,* 287 U. S. 77, 83;
Old Colony R. R. Co. v. *Commissioner,* 284 U. S. 552, 560;
Crooks v. *Harrelson,* 282 U. S. 55, 61;
United States v. *Merriam,* 263 U. S. 179, 187;
Hamilton v. *Rathbone,* 175 U. S. 414, 421;
United States v. *Goldenberg,* 168 U. S. 95, 102.

The following statement by Lord CAIRNS from *Partington* v. *Attorney-General,* L. R. 4 H. L. 100, 122, was approved in *United States* v. *Merriam, supra,* and *Crooks* v. *Harrelson, supra:*

> "I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

That a real danger lurks in departures from the plain language of statutes has repeatedly been emphasized by this Court. The following passage from the opinion in *Pirie* v. *Chicago Title & Trust Co.,* 182 U. S. 438, 451, 452, is peculiarly applicable to the present case:

> "But all legislation is not simple, nor its consequences obvious, or to be controlled, even if obvious. Whether there should be any legislation at all, and

its extent and form, may be matters of dispute. Its consequences may be viewed with favor or with alarm; some regretted, but accepted as inevitable,—accepted as the shadow side of the good. In such situation it is for the legislature to determine, and it is very certain that the judiciary should not refuse to execute that determination from its view of some consequence which (to use the thought and nearly the words of Chief Justice MARSHALL) may have been contemplated and appreciated when the act was passed, and considered as overbalanced by the particular advantages the act was calculated to produce."

Bearing in mind that the reorganization provisions provided for deferring recognition of *losses*, as well as of gains, the following warning in *Van Camp & Sons* v. *American Can Co.*, 278 U. S. 245, 253, is especially significant:

> "The words being clear, they are decisive. There is nothing to construe. To search elsewhere for a meaning either beyond or short of that which they disclose, is to invite the danger, in the one case, of converting what was meant to be open and precise, into a concealed trap for the unsuspecting, or, in the other, of relieving from the grasp of the statute some whom the legislature definitely meant to include."

In *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370, the Court said:

> "And the plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

III.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the intent of Congress.

A. THE INTENT OF CONGRESS TO DEFER RECOGNITION OF GAIN IN FORMAL INTERCORPORATE READJUSTMENTS IS INDICATED BY THE HISTORY OF THE REORGANIZATION PROVISIONS OF THE REVENUE ACTS.

If the intent of Congress needs proof outside the plain language of the statute, it is shown by the history of the definition of reorganization and of collateral provisions of the revenue acts.

As early as 1921 Congress had definitely in mind the advisability of relieving the stagnation in the sale and exchange of capital assets which had resulted from the high surtaxes on capital gains. To encourage *sales* an alternative flat tax of 12½ per cent. was imposed by Section 206 of the Revenue Act of 1921 on the sale of capital assets held for more than two years. The occasion for such a provision was stated in the Report of the Committee on Finance (No. 275, 67th Congress, 1st Session) as follows:

> "Section 206 limits the rate of taxation upon gain derived from the sale of capital assets. Under the present law many sales of farms, mineral properties, and other capital assets have been prevented by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum and the amount of surtax excessively enhanced thereby."

See *Burnet* v. *Hamel*, 287 U. S. 103, 105, 106 (1932); the statement of Chairman Green of the Committee on Ways

and Means in the debate on the Revenue Bill of 1924 (LXV Congressional Record 2428); and the Annual Report of the Secretary of the Treasury for the year ended June 30, 1921, pp. 19, 20.

Similarly, to encourage *exchanges* of capital assets, particularly in connection with intercorporate transactions, the principle was adopted of postponing the imposition of the tax until actual realization of the gain by sale, and meanwhile to withhold recognition of gain so long as the taxpayer's investment in assets held in corporate form was not terminated, but was merely continued in different corporate form. An outline of the development of the exchange and reorganization provisions follows.

In connection with the history of these statutory provisions it will be recalled that Mrs. Gregory, previously the owner of the stock of one corporation, through intercorporate transactions became the owner of the stock of two corporations, which together owned the same assets previously owned by the one corporation, thus continuing her investment except for a change in form, and that thereafter she derived a gain from the dissolution of one corporation and the sale of its property, thereby terminating her investment *pro tanto*. The desirability of the ultimate sale in question was enhanced by the ameliorating effect of the reorganization and capital gain provisions of the statute, which were intended to accelerate just such a transaction.

Revenue Acts of 1913, 1916, 1917, 1918 and 1921. The Acts of 1913, 1916 and 1917 contained no specific provisions with respect to exchanges of property, whether or not in connection with intercorporate transactions, and consequently no definition of reorganization. The Act of 1918 in Section 202 (b) for the first time expressly prescribed the treatment of exchanges of property, and excepted from

the recognition of gain or loss the exchange of stock or securities for new stock or securities of no greater aggregate par or face value in connection with the "reorganization, merger, or consolidation of a corporation," leaving the meaning of "reorganization" to be gathered from the context or from ordinary usage. The Act of 1921 incorporated in Section 202 enlarged and more specific exchange and reorganization provisions, worked out from a draft submitted by the Treasury Department (Hearings before Committee on Ways and Means, July 26-29, 1921, p. 406), including in subdivision (c) (2) a definition of "reorganization" like that in Section 112 (i) (1) of the Revenue Act of 1928, exclusive of clause (B), which is involved here. (See Appendix, p. 55.) In the Report of the Committee on Finance of the Senate on the Revenue Bill of 1921 (No. 275, 67th Congress, 1st Session), it was said:

> "Section 202 (subdivision c) provides new rules for those exchanges or 'trades' in which, although a technical 'gain' may be realized under the present law, the taxpayer actually realizes no cash profit."

Revenue Act of 1924. Prior to the introduction in Congress of the Revenue Bill of 1924 the Treasury Department gave extensive consideration to the revision of the reorganization provisions of the 1921 Act, and adopted the policy of prescribing in the statute comprehensive and precise provisions to cover every possible situation. Among other things, it contemplated extending the definition of "reorganization" to include "a division of all or a part of the assets of one corporation into one or more corporations", but this language, being regarded as insufficiently specific, was replaced in the draft of bill submitted by the Treasury Department to the Committee on Ways and Means

(Committee Print No. 1, December 17, 1923) by the more exact provision which has come to be known as clause (B) of the definition. This new clause defined "reorganization" to mean:

> "(B) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred."

The definition of reorganization so amplified was accepted by Congress and enacted without change in the Revenue Act of 1924 (Section 203 (h) (1)), and has continued without change in the Revenue Acts of 1926 (Section 203 (h) (1)), 1928 and 1932 (Section 112 (i) (1)) and, so far as clause (B) (relettered clause (C)) is concerned, in the Revenue Act of 1934 (Section 112 (g) (1)).

During the consideration of the Revenue Bill of 1924 by the Ways and Means Committee it released a statement prepared by Special Assistant to the Secretary of the Treasury Gregg with reference to the changes from the 1921 Act proposed by the Department, and adopted by Congress, containing detailed explanations of the painstakingly formulated provisions of Sections 203 and 204 relating to recognition of gain or loss from sales or exchanges and to the basis for determining gain or loss. (See Appendix C to Miller, "Reorganizations and Other Exchanges in Income Taxation".) These explanations were largely repeated in the Report on the bill of the Committee on Ways and Means (No. 179, 68th Congress, 1st Session) and in the Report of the Committee on Finance (No. 398, 68th Congress, 1st Session).

Generally with respect to Section 203 the Reports of

the House and Senate Committees (following the Gregg statement) said (italics ours):

> "The existing law provides, in section 202 (*c*), that no gain or loss is recognized (that is, considered for the purpose of determining taxable income) from an exchange of property unless the property received in exchange has a readily realizable market value.
>
> The provision is so indefinite that it cannot be applied with accuracy, nor with consistency. It appears best to provide generally that gain or loss is recognized from all exchanges and then except specifically and in definite terms those cases of exchanges in which it is not desired to tax the gain or allow the loss. *This results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom.*"

As a reason for modifying the provision (Section 202 (*c*) (1) of the 1921 Act) relating to the exchange of property held for investment or for productive use, the Report of the Senate Committee (following the Gregg statement) said (italics ours):

> "In the bill the language is changed to provide that the property held for investment or for productive use must be exchanged for a like kind of property. If the property received is of a like kind, it is immaterial whether it is to be held for investment or for productive use. *The intention of the party at the time of the exchange is difficult to determine, is subject to change by him, and does not represent a fair basis of determining tax liability.*"

As to another specific paragraph (corresponding to Section 112 (b) (4) of the Revenue Act of 1928, Appendix, p. 54), the Report of the House Committee (similarly to the Re-

port of the Senate Committee and the Gregg statement) said (italics ours):

> "Paragraph (3) provides that no gain or loss is recognized if a corporation, a party to a reorganization, exchanges property for stock or securities in another corporation, a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. *The statute should contain a definite rule on this question.*
>
> Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented on account of the provisions of the tax law. If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation."

Commenting on the provision in Section 203 (c) of the 1924 Act for permitting the distribution without tax of stock of a party to a reorganization (corresponding to Section 112 (g) of the Revenue Act of 1928, Appendix, p. 54), which has appeared without change in the Acts of 1926, 1928 and 1932, but was omitted in the Act of 1934, the Report of the Senate Committee (following the Report of the House Committee and the Gregg statement) said:

> "Section 203 (c): There is no provision of the existing law which corresponds to subdivision (c). Under the existing law, if Corporation A organizes a subsidiary, Corporation B, to which it transfers part of its assets in exchange for all the stock of Corporation B, and then distributes the stock of Corporation B as a dividend to its stockholders without the surrender by the stockholders of any of their stock, then

such a dividend is a taxable one. If, however, Corporation A organizes two new corporations, Corporations B and C, and transfers part of its assets to Corporation B and part to Corporation C, and the stockholders of Corporation A surrender their stock and receive in exchange therefor stock of Corporations B and C, no gain from the transaction is recognized. Thus, under the existing law, the same result, except as to tax liability, may be obtained by either of two methods; but if the first method set out above is adopted, the gain is taxable while if the second method set out above is adopted, there is no taxable gain. Subdivision (c) of the bill permits the reorganization to be accomplished in the first manner set out above without the recognition of gain. The first method set out above represents a common type of reorganization and clearly should be included within the reorganization provisions of the statute."

As to the insertion in the definition of reorganization of clause (B) (corresponding to Section 112 (i) (1) (B) of the Revenue Act of 1928, Appendix, p. 55), the Reports of the House and Senate Committees (following the Gregg statement) said:

"Section 203 (h)-(1): Subdivision (h) (1) contains a definition of reorganization which corresponds to the definition contained in section 202 (c) (2) of the existing law. *The only change in the definition is to include within its terms the case of a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders, or both, are in control of the corporation to which the assets are transferred.* This is a common type of reorganization and clearly should be included within the reorganization provisions of the statute."

Generally with respect to Section 204, relating to the basis for ascertaining gain or loss, the Reports of the House and Senate Committees (following the Gregg statement) said (italics ours):

> "The general theory of this section is that where no gain or loss is recognized as resulting from an exchange, the new property received shall for purposes of determining gain or loss from a subsequent sale, and for depreciation and depletion, be considered as taking the place of the old property given up in connection with the exchange. The provisions of section 203 of the bill that no gain or loss is recognized from certain exchanges, do not grant an exemption and are not so intended. These provisions are based upon the theory that the types of exchanges specified in section 203 are merely changes in form and not in substance, and consequently should not be considered as effecting a realization of income at the time of the exchange. *In other words, these provisions result not in an exemption from tax but in a postponement of tax until the gain is realized by a pure sale or by such an exchange as amounts to a pure sale.* It follows, therefore, that in the case of such an exchange, the property received should be considered as taking the place of the property exchanged."

As an example of the computation of the base in the case of distributions in connection with a reorganization (see Section 113 (a) (9) of the Revenue Act of 1928, Appendix, p. 56), the Reports of the House and Senate Committees (following the Gregg statement) said:

> "Example A: A purchased a share of stock in corporation X for $100. Corporation X organizes a subsidiary, corporation Y, to which it transfers a part of its property in exchange for all of the stock of corporation Y. It then distributes the stock of corporation Y, share for share, to its stockholders as a dividend.

Under the provisions of subdivision (c) of section 203 of the bill, A realizes no income from the receipt of this stock.

The basis of the share of stock in corporation X, $100, shall, under this paragraph, be apportioned between the share of stock in corporation X and the share of stock in corporation Y. If at the time of the distribution of the share of stock in corporation Y, the stock of the two corporations is of the same market value, then one-half of the basis of the old stock, $50, shall be apportioned to each share. Gain or loss from the subsequent sale of either share of stock shall be determined by comparing the sale price with $50, the basis of the share sold."

Revenue Acts of 1926 and 1928. No changes from the Revenue Act of 1924 were made in the reorganization provisions in the Revenue Acts of 1926 and 1928. Section 203 of the 1924 and 1926 Acts became Section 112 of the 1928 Act, with subdivisions (c), (g) and (h) of the former Acts relettered as subdivisions (g), (h) and (i) of the later Act.

Revenue Act of 1932. The only changes in Section 112 of the Act of 1928 made in the Act of 1932 were the addition of a new subdivision (k), relating to transfers to foreign corporations, and the insertion in another subdivision of a clause made necessary by such addition, neither change affecting the definition of reorganization.

Revenue Act of 1934. Although prior to the introduction of the Revenue Bill of 1934 a sub-committee of the Committee on Ways and Means had recommended the abolition of the reorganization provisions, and the Treasury Department had advocated their complete redrafting so as to express them simply and generally, the bill as enacted into law retained intact the definition of reorganization in clause (B), while slightly modifying the definition

in clause (A), with which we are not concerned. (See Section 112 (g) of the Revenue Act of 1934.) The provision permitting the tax-free distribution of stock of a corporation a party to a reorganization, without surrender of the old stock (Section 112 (g) of the Revenue Act of 1928, Appendix, p. 54), was omitted from the 1934 Act.

To summarize, clause (B) of the definition of reorganization has appeared without change in the Acts of 1924, 1926, 1928, 1932 and (relettered clause (C)) 1934. It was retained in the 1934 Act on the "broad principle", as newly expressed by the Committee on Ways and Means, "that no taxable profit is realized from a reorganization, if no money passes and if the changes in corporate organization are essentially changes only in form." However, the provision of the 1924, 1926, 1928 and 1932 Acts for the tax-free distribution, without the surrender of the old stock, of stock in a corporation a party to a reorganization, was repealed, as permitting tax avoidance. (See Report of Committee on Ways and Means (No. 704, 73rd Congress, 2d Session) on Revenue Bill of 1934). Under the 1934 Act, therefore, the transfer from the United Corporation to Averill Corporation would still constitute a reorganization within the language of the statute, but the distribution of the Averill stock would no longer be without tax.

B. CONGRESS DID NOT INTEND THAT REORGANIZATIONS BE JUDGED BY THE MOTIVES INDUCING THEM.

The Circuit Court in its opinion maintains that, even though a readjustment conformed with the express provisions of the definition of reorganization, and even though "the collective interests still remained in solution", nevertheless the readjustment would not be a reorganization un-

less undertaken "for reasons germane to the conduct of the venture in hand", and that the reduction of the stockholders' taxes and the consequent increase in the net profit on the sale of an investment was not a reason germane to the conduct of the venture in hand or an ordinary business purpose. Neither proposition finds any support in the revealed intent of Congress or in common commercial concepts.

The Circuit Court attempts to support its construction of clause (B) of the definition of reorganization by stating that it accords with the history of the section. It is said that clause (B) was intended as supplementary to the provision permitting the tax-free distribution, in connection with a reorganization, of stock of a party to a reorganization, without surrender of the stockholders' old stock, and that in the House Report and the Senate Report on the 1924 bill the purpose was stated to be to exempt "from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented." The first proposition is at least doubtful, as will have been observed from the historical outline above, particularly as the provision which clause (B) was intended to supplement, according to the Circuit Court, has been eliminated from the 1934 Act, although clause (B) is retained. As to the second proposition, the paragraph from which the phrase was quoted, as set forth above (p. 19), refers to earlier statutes and appears, not in connection with the explanation of the insertion of clause (B), but in connection with another new provision of the 1924 Act. More pertinent are the statements from the Gregg and the Committee reports quoted above (p. 18) that the specific exception from tax of certain cases of exchanges "results in definiteness and accuracy and enables a tax-

payer to determine prior to the consummation of a given transaction the tax liability that will result therefrom", and that "the intention of the party at the time of the exchange is difficult to determine, is subject to change by him, and does not present a fair basis of determining tax liability."

A fundamental fallacy of the decision below appears to lie in the Circuit Court's confusion of intent and motive and in the disregard of intent in an attempt to make motive control the construction of the statute. The *motive* of Congress in enacting the reorganization provisions was doubtless to facilitate ordinary business transactions, as well as, among other things, to collect more taxes in the long run, and to enable both taxpayers and the Treasury Department definitely to determine in advance whether any corporate readjustment would result in taxable gain. The *general intent* of Congress was to postpone recognition of gain or loss so long as a taxpayer's investment was in essence continued, although in different corporate form. Its *specific intent* was to postpone recognition of gain or loss upon exchanges or distributions in connection with a "reorganization", which as expressly defined in clause (B) comprised a transfer by a corporation of assets to another corporation if immediately after the transfer the transferor or its stockholders owned 80 per cent. of the stock of the transferee corporation.

Concretely, the intent of Congress was to stamp as a "reorganization", for the purposes of the reorganization provisions, a transaction by which corporation X transferred asset M to corporation Y in exchange for 80 per cent. or more of the stock of corporation Y (or less if corporation X or its stockholders already owned stock of corporation Y). X would continue its interest in the asset

M through its control of the stock of Y corporation, or, if the stock of Y were distributed to the stockholders of X, they would hold the stock of both corporations together having the same assets as the former single corporation. It may be that the motive for such a transaction was to incorporate a branch of X in another State, for business convenience or to reduce State taxes; or to effect a segregation, required by law, of part of the assets of X; or to permit the subsequent acquisition by third persons of an interest in Y corporation and its assets through an additional issue of its stock, or the sale of stock already issued. What of it, so long as the transaction described in the statute took place and *immediately* thereafter the transferor corporation or its stockholders had the required control of the transferee corporation?

In the present case corporation X transferred asset M to corporation Y in exchange for all the stock of Y, which was distributed to the sole stockholder of X. She then owned all the stock of both corporations, which together had the same assets as the former single corporation,—precisely the situation intended by the statute. Her investment was not terminated by the segregation, but continued in different corporate form. If because Mrs. Gregory preferred two stock certificates instead of one, or if for any other reason, frivolous or otherwise, she had brought about this segregation and had continued indefinitely to hold the stock of Y, it is hard to believe that the reorganization would have been questioned.

Clearly, the controversy arose because *after* the statute had been satisfied she caused the dissolution of Y corporation and terminated her investment to that extent. Yet the view of the Circuit Court, as expressed in its opinion, seems to be that the dissolution of the Averill Corpo-

ration, following the corporate readjustment, was material only as evidence of the purpose or motive in consummating the various transactions, in other words, as evidence that the reasons for undertaking the readjustments were not germane to the conduct of the venture in hand. If this conception be correct, then, if there was no reorganization on the facts as they existed, there would equally have been no reorganization if just prior to the dissolution of the Averill Corporation Mrs. Gregory had changed her mind and continued to hold its stock. The difficulties in applying such a criterion based on motives and reasons are sufficiently patent.

It can scarcely be, on the other hand, that the Court regarded the dissolution of the Averill Corporation, not as evidence of motives, but as a transaction altering the effect of the transactions which had previously taken place, for the definition of reorganization emphasizes the necessity for control only "immediately after the transfer" and obviously contemplates a possible sale or other disposition of the stock of the controlled corporation at any time thereafter. A condition subsequent that there should be no early sale or other action terminating control cannot possibly be read into the statute. Even the Circuit Court's view of a condition precedent based on motives is more logical than this construction. In fact, in 1924, when clause (B) of the definition was first enacted, Congress was well aware, and adopted the broadened reorganization provisions having in mind, that there were a number of pending proceedings for the division of corporate properties, such as the segregation of coal properties from railroads, in which the courts required the early sale of the stock of corporations formed to take over such segregated properties. (See *United States* v. *Lehigh Valley R. R.*

Co., 254 U. S. 255, and Poor's Manual of Railroads for 1924, at page 347; G. C. M. 2177, VI-2 C. B. 112. See also p. 49 below.)

The Circuit Court in the present case, after recognizing that corporate readjustments were not to be considered as "realizing" any profit, where "the collective interests still remained in solution", gave as its *ratio decidendi*:

> "But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution."

Such presupposition seems far from plain, if the investment is not terminated by the reorganization, but continues, however briefly, in different corporate form. Nothing appears in the statute or in the intent of Congress, repeatedly expressed as set out above, to reveal the existence of such a presupposition or to warrant giving it controlling effect over the language of the statute. The Circuit Court's decision is based entirely on the assumption that such a presupposition exists and not only underlies, but overrides, the statute.

Every reference to the reorganization provisions in the reports of the Committees of Congress makes it clear that the intent of Congress was to postpone recognition of taxable gain so long as there were merely formal corporate readjustments and until there was an actual realization of a cash profit or its equivalent. In the present case the transfer of the Monitor stock to the Averill Corporation and the distribution of the Averill stock to Mrs. Gregory were formal readjustments recognized by Congress in the statute as involving the realization of no taxable gain, and it was not until the dissolution of the Averill Corporation and the distribution by it of the Monitor stock that

the equivalent of a cash profit was realized. At that point, and not until that point, Mrs. Gregory's gain was subject to tax in accordance with the definite provisions of the statute and the equally definite intent of Congress. The tax on such gain computed in exact conformity with the statute and regulations has been paid.

C. NEVERTHELESS THE DISPOSITION OF INVESTMENTS WITH THE GREATEST ULTIMATE PROFIT IS A REASON GERMANE TO THE CONDUCT OF BUSINESS.

But the Circuit Court further assumes that the motive of minimizing taxes is not a reason germane to the conduct of the venture in hand. If it were, the Court's conclusion would evidently be different.

It will be recalled that there was a market for the Monitor stock held by the United Corporation which was favorable to its sale if the expenses and burdens of sale were not excessive, in other words, if the net profit were worth while. If the United Corporation sold the Monitor stock and distributed the proceeds to Mrs. Gregory, there would be income taxes on both corporation and stockholder; if the United Corporation distributed the Monitor stock to Mrs. Gregory and she sold it, she would be taxable at surtax rates on its full value as upon an ordinary dividend; if the Monitor stock were transferred in exchange for stock of the Averill Corporation, which was distributed to Mrs. Gregory, and then she received the Monitor stock in complete liquidation of the Averill Corporation, she would be taxable as upon a sale of the stock of the Averill Corporation. On this last basis the net avails to the ultimate stockholder were sufficient to warrant the transaction, and the reorganization was consummated with the ordinary business motive, actuating most corporations, of making or saving the most net profit for the stockholders.

In the case of an investment company the disposition of investments most advantageously to its stockholders seems quite germane to the venture. As said by Mr. R. N. Miller in "Corporate Reorganizations: The Present Situation", published in the Tax Magazine for September, 1934 (Vol. XII, No. 9):

> "Tax problems are certainly 'germane' in the sale or exchange of assets when the rates are high. The money which is paid to the Government because of a tax levy is gone just as truly and finally as if it is paid out for expenses; the practical question in any sale or any exchange is how much the seller will have left of his capital after all the consequences have been met, and this figure is lessened by an increase in the amount of taxes just as much as it is by a decrease in the amount of selling price or value of property received."

It may be wondered what the Circuit Court would have decided in the case of a New York corporation doing business throughout the United States, which transferred its California property in exchange for the stock of a California corporation, with the motive of avoiding the stockholders' liability for corporate debts, including taxes, until recently imposed by California law. Obviously such readjustment would not have been consummated for the benefit of the New York corporation itself, but to relieve its stockholders of liability. Would it be regarded as not undertaken for reasons germane to the conduct of the venture in hand?

D. When Congress has intended the purpose of a transaction to control it has expressly so provided.

The Circuit Court also points out, to support its conclusion, that "the act itself gives evidence that, on occasion anyway, the purpose of a transaction should be the guide",

referring to Section 115 (g) and Section 112 (c) (2) of the 1928 Act, relating to distributions in specified circumstances which have the effect of a taxable dividend. The Court seems to have answered its own argument by showing that, where Congress has intended the purpose or effect of a transaction to be controlling, it has been able to say so in express language, without compelling recourse to surmises and assumptions. Thus, also, in Section 112 (k) of the Revenue Act of 1932, enacted in order to restrict the growing use of foreign corporations in connection with reorganizations, Congress prescribed that a foreign corporation should not be considered a corporation unless it had been established to the satisfaction of the Commissioner that any exchange or distribution was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.

Although, as shown by the foregoing history of the reorganization provisions, a policy of liberalization prevailed until recently, nevertheless, where there appeared to be defects in the provisions of the statute, Congress corrected them without relying on judicial legislation. In Section 204 (a) (7) of the 1924 and 1926 Acts, relating to the basis for determining gain or loss, it was provided that the basis for property "(other than stock or securities in a corporation a party to the reorganization)" acquired by a corporation in connection with a reorganization should be the same as it would be in the hands of the transferor. In order to avoid the limitation on the basis for property to its cost to its former owner, many reorganizations were planned in such a way that the property acquired was "stock or securities in a corporation a party to the reorganization", thereby taking advantage of the exception embodied in the parenthetical clause. This method of tax avoidance was sustained, even though it was contended

that Congress did not intend the result which could be accomplished under it. (G. C. M. 7285, IX-1 C. B. 181 (1930)) In Section 113 (a) (7) of the 1928 Act the provision in question was amended to eliminate the parenthetical clause, but without any attempt to make such modification retroactive. Again, with respect to the same provision, which in the 1928 and prior Acts required an 80 per cent. control to be operative, Congress modified it in Section 113 (a) (7) of the 1932 Act to require only a 50 per cent. control. In the 1934 Act, as we have seen, Congress omitted Section 112 (g) of the 1928 and prior Acts on the ground that it permitted tax avoidance.

But clause (B) of the definition of reorganization still stands without modification as it has since 1924. Every examination of the intent of Congress must lead to the conclusion that its lucid language requires no interpreter and does not need or permit such an appendage as, "provided the readjustment was undertaken for reasons germane to the conduct of the venture in hand". In "Statutory Interpretation", 43 Harvard Law Review 863, Mr. Max Radin said (p. 866):

> "Words are certainly not crystals, as Mr. Justice Holmes has wisely and properly warned us, but they are after all not portmanteaus. We can not quite put anything we like into them. And we may not disregard them in statutes."

It appears, therefore, that the intent of Congress in enacting clause (B) of the definition of reorganization was to defer recognition of gain or loss so long as the changes in corporate organization were essentially changes only in form, regardless of the motives for them, and until the gain or loss should be realized by a sale; that in any event the attainment of the greatest possible net profit for stock-

holders is a reason germane to the conduct of the venture in hand and a motive which properly may and does actuate ordinary business transactions; and, finally, that when Congress desired taxpayers' motives or the effect of a transaction to affect their tax liability it has said so in no uncertain terms, finding no difficulty in amending the statute whenever the occasion warranted it. In short, not only is clause (B) definite and precise in its language and ordinary meaning, but no actual or constructive intent of Congress can be discovered or inferred which might create any ambiguity.

IV.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the regulations and rulings of the Treasury Department.

The regulations of the Treasury Department have always construed the reorganization provisions of the statute to mean what they said.

As to the definition of reorganization in Section 112 (i) (1) of the 1928 Act (Appendix, p. 55), Regulations 74 of the Department prescribed in Article 577 (italics ours):

> ART. 577. **Definitions.**—The term "reorganization", as used in sections 112, 113 and 115 means—
>
> (1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) *A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,*

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent. of the voting stock, and

(2) At least 80 per cent. of the total number of shares of all other classes of stock of the corporation. . . .

This regulation in the same form was first promulgated as Article 1577 of Regulations 65 under the 1924 Act and also appeared without change as Article 1577 of Regulations 69 under the 1926 Act and Article 577 of Regulations 77 under the 1932 Act.

As to exchanges and distributions in connection with a reorganization under Section 112 of the 1928 Act (Appendix, p. 54), Regulations 74 prescribed in Articles 574 and 576 (italics ours):

ART. 574. **Exchanges in connection with corporate reorganization.**—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reor-

ganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. If two or more corporations reorganize, for example, by—

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or

(4) *The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation*—

then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.) . . .

ART. 576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

Article 576 first appeared as Article 1576 of Regulations 65 under the 1924 Act and was repeated without change as Article 1576 of Regulations 69 under the 1926 Act and Article 576 of Regulations 77 under the 1932 Act. Article 574 appeared without change as Article 574 of Regulations 77 under the 1932 Act, and is substantially similar to the corresponding portions of Article 1574 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act.

As to the source of the distribution of stock in a reorganization, provided for in Section 112 (h) of the 1928 Act (Appendix, p. 55), see Article 578 of Regulations 74 (similar to Article 1578 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act and to Article 578 of Regulations 77 under the 1932 Act); and as to the basis for ascertaining gain or loss on the sale of property acquired in a reorganization, whether by a corporation or its stockholders, as provided for in Section 113 (a) (7) and (9) of the 1928 Act (Appendix, p. 56), see Articles 598 and 600 of Regulations 74 (similar to Articles 1598 and 1600 of Regulations 65 under the 1924 Act and of Regulations 69 under the 1926 Act and to Articles 598 and 600 of Regulations 77 under the 1932 Act).

As no regulations have yet been promulgated under the 1934 Act, this completes the review of pertinent regulations issued since the enactment in the Revenue Act of 1924 of clause (B) of the definition of reorganization (see

Point III above), with which, as Section 112 (i) (1) (B) of the 1928 Act (Appendix, p. 55), we are here concerned.

It is significant that the statement of the definition of reorganization in clause (B) contained in the regulations above quoted is entirely unqualified, just as is the language in the successive statutes. Certainly, if the Treasury Department had had any intention of trying to write into the statutory definition any qualification or condition, as the Court below has attempted to do in this case, such intention would have been expressed in some of these regulations.

With respect to rulings of the Treasury Department less formal than regulations, they are few so far as they bear on the proper interpretation of clause (B) of the definition of reorganization, because it was too clearly expressed to require construction. Never, to the knowledge of counsel, has the Department ruled, prior to the decision of the Circuit Court in this case, that a transfer by a corporation of a part of its assets to another corporation in exchange for all its stock was not a reorganization within any of the Revenue Acts from 1924 to 1934.

Indeed, in S. M. 4911, V-1 C. B. 250 (1926), the Solicitor of Internal Revenue ruled:

> "The Department has consistently given effect to the doctrine of separate corporate entity, regardless of consequences, wherever corporate organizations are availed of in good faith and within the law, even as to cases wherein the corporate organization or transaction is admittedly undertaken solely for the purpose of avoiding tax liability."

See also L. O. 1062, 4 C. B. 168, 171; G. C. M. 3008, VII-1 C. B. 235.

In I. T. 2542, IX-2 C. B. 126 (1930), the M Company for a minority issue of its stock acquired a minority stock interest in the N Company, without recognition of gain to the transferor stockholders of the N Company, *by interposing a new corporation, the O Company,* which acquired the N minority stock for all its stock and then transferred the N stock, comprising all its assets, in exchange for M stock, thereupon dissolving and distributing the M stock to its stockholders, the former holders of N stock, upon their surrender of their O stock. These transactions, being in conformity with the statute, were recognized to constitute a reorganization under clause (A) of the definition of reorganization, although the O Company was organized and quickly dissolved solely for tax avoidance purposes.

In G. C. M. 2177, VI-2 C. B. 112, 114 (1927), involving the segregation of coal properties of the Reading Company in a new corporation, the Treasury Department ruled:

> "The fact that at some later date to be determined by the court one of the two holdings was required to be disposed of does not change the fact that immediately after the transfer the M Company, or its stockholders, or both, were in control of the R Company, within the meaning of section 203 (i) of the 1924 Act. . . ."

In *Evans Products Company* v. *Commissioner,* 29 B. T. A. 992 (1933), A, who owned all the stock of X, agreed to sell a 51 per cent. interest therein to B. To escape income tax A organized corporations Y and Z and exchanged his stock in X for the stock of Y, which thereupon exchanged the stock of X for the stock of Z, and Z thereupon liquidated X. Then Y sold to B 51 per cent. of the stock of Z. All these transactions took place within three

days. Nevertheless, the Commissioner conceded that there was a reorganization.

In general, so far as is revealed by published rulings of the Treasury Department, it has never departed from the position that the question whether or not a reorganization existed under a particular state of facts must be determined from the language of the statute and without reference to the purposes or motives of those who carried out the transactions.

I. T. 2259, V-1 C. B. 18 (1926);
G. C. M. 1345, VI-1 C. B. 15 (1927);
G. C. M. 1753, VI-1 C. B. 138 (1927);
I. T. 2530, IX-1 C. B. 194 (1930).

In G. C. M. 7285, IX-1 C. B. 181 (1930), full effect was given to the parenthetical clause in Section 204 (a) (7) and (8) of the Revenue Acts of 1924 and 1926, which permitted a stepped-up basis if the property acquired in a reorganization was stock or securities in a corporation a party to a reorganization. Although, until this clause was eliminated in Section 113 (a) (7) and (8) of the Revenue Act of 1928, it was extensively exploited in formulating reorganization plans, the General Counsel of the Internal Revenue Bureau ruled (p. 184):

> "It has been suggested, because the exceptions contained in section 204 (a) 7 and 8 have been omitted, so far as the transactions herein discussed are involved, from the corresponding section of the Revenue Act of 1928, that the provisions of the Revenue Act of 1928 may properly be taken as interpretative of the Revenue Act of 1926. With this contention this office does not agree. The corresponding section of the Revenue Act of 1928 (section 113) was not made retroactive, and there is nothing in the statute to indicate that Congress intended that the section should

be given retroactive application in any particular. The provisions of the Revenue Act of 1926, above quoted, are clear and unambiguous. In the absence of ambiguity in the statutes, the courts will not look beyond the language of the statute itself. As stated in 25 Ruling Case Law, page 962:

> '. . . When the language of the statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction; the statute must be given its plain and obvious meaning. This principle is to be adhered to notwithstanding the fact that the court may be convinced by extraneous circumstances that the legislature intended to enact something very different from that which it did enact.'

To the same effect, see also *Lake County* v. *Rollins* (130 U. S., 662); *United States* v. *Merriam* (263 U. S. 179 (T. D. 3535, C. B. II-2, 87)); *Penn Mutual Life Insurance Co.* v. *Lederer* (252 U. S., 523 (T. D. 3046, C. B. 3,249)); *New York Telephone Co.* v. *Treat* (130 Fed., 340, certiorari denied 198 U. S., 584); and Lewis' Sutherland Statutory Construction, section 363."

It is noteworthy that Miller on "Reorganizations and Other Exchanges in Federal Income Taxation", a standard work, which was cited by the Board in its opinion, contains no suggestion that the validity of a transaction within the reorganization provisions of the statute might be impaired by a motive of tax avoidance or by reasons not "germane to the conduct of the venture in hand". If any of the rulings or decisions had shown any support for construction of the statute based on motives, the author would have been obliged to discuss that subject. In 1931, when this book was published (some three years after the transactions here at issue), no one in or out of the Treasury Department

supposed that the language of the definition of reorganization could be affected or distorted by the taxpayer's motives, although clause (B) had been in effect since 1924, and clause (A) since 1921.

The manner of reporting her income and of computing the tax thereon employed by Mrs. Gregory in her return, and confirmed by the Board of Tax Appeals herein, was strictly in conformity with all regulations and rulings of the Treasury Department. The position adopted by the Circuit Court of Appeals in its opinion has never at any time been advanced by the Treasury Department in its regulations or rulings.

In *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, the Court said with respect to pertinent articles of Regulations 45 of the Treasury Department, relating to the income tax under the 1918 Act (p. 378):

> "The regulations were made pursuant to express authority (see § 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. *United States* v. *Grimaud,* 220 U. S. 506, 517, 518, 55 L. ed. 563, 567, 568, 31 S. Ct. 480; *International R. Co.* v. *Davidson,* 257 U. S. 506, 514, 66 L. ed. 341, 346, 42 S. Ct. 179. They constitute contemporaneous construction by those charged with the administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons. *United States* v. *Moore,* 95 U. S. 760, 763, 24 L. ed. 588, 589; *Brewster* v. *Gage,* 280 U. S. 327, 336, 74 L. ed. 457, 462, 50 S. Ct. 115."

The regulations promulgated by the Treasury Department under the 1924 Act, the 1926 Act, and the 1932 Act, as well as under the 1928 Act, with no informal rulings not in conformity therewith, consistently recognized as a "reorganization" the transfer by a corporation of a part of

its assets to another corporation in exchange for all of its stock, with no suggestion of condition precedent or subsequent derived from the motives inducing the transaction or otherwise. The executive interpretation thus placed upon the definition of reorganization must, in view of the repeated reenactment of the statute without change, be deemed to have received implied legislative recognition and approval. Congress is presumed to have legislated with knowledge of an established usage of an executive department of the Government.

National Lead Company v. *United States*, 252 U. S. 140, 146;

Wisconsin v. *Illinois*, 278 U. S. 367, 413;

United States v. *Kirby Lumber Co.*, 284 U. S. 1, 3;

Old Colony R. R. Co. v. *Commissioner*, 284 U. S. 552, 557;

Massachusetts Mutual Life Insurance Co. v. *United States*, 288 U. S. 269, 273.

V.

The transfer by United Mortgage Corporation of a part of its assets to Averill Corporation in exchange for the issue of all the stock of Averill Corporation was a reorganization within the decisions of the Courts.

In the present case the Board of Tax Appeals and the Circuit Court of Appeals agreed that the motive to minimize taxes did not vitiate a transaction or warrant disregard of the corporate entity. The Board said (R. 10):

> "The purpose to reduce taxes does not control the recognition of the corporation, *Bullen* v. *Wisconsin*, 240 U. S. 625, nor does the extent of its legitimate

function or operations. Its existence can not be denied to escape liability, *Nowland Realty Co.* v. *Commissioner,* 47 Fed. (2d) 1018; *People* v. *Williams,* 198 N. Y. 54; 91 N. E. 266; *112 West 59th Street Corp.,* 23 B. T. A. 767, and with equal force it may enjoy its corporate benefits. That the petitioner was its sole shareholder does not serve to obscure its identity, *Planters Cotton Oil Co., Inc.* v. *Hopkins,* 286 U. S. 332, else the United Corporation would likewise be obliterated, and this is not suggested. The shortness of its life does not indicate less than a complete entity while it lived. *Regal Shoe Co.,* 1 B. T. A. 896."

The Circuit Court said (R. 35, 37):

"We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. *U. S.* v. *Isham,* 17 Wall. 496, 506; 21 L. Ed. 728; *Bullen* v. *Wisconsin,* 240 U. S. 625, 630, 36 S. Ct. 473, 60 L. Ed. 830. . . .

. . . we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, . . ."

This Court in recent tax cases has had occasion to consider urgent demands for the disregard of corporate

entities and in every instance has sustained their full recognition.

New Colonial Ice Co., Inc. v. *Helvering,* 292 U. S. 435;

Burnet v. *Commonwealth Improvement Company,* 287 U. S. 415;

Burnet v. *Clark,* 287 U. S. 410;

Dalton v. *Bowers,* 287 U. S. 404;

Planters Cotton Oil Co. v. *Hopkins,* 286 U. S. 332;

Klein v. *Board of Supervisors,* 282 U. S. 19.

It has also often been held that a purpose to minimize or avoid taxes is immaterial.

Superior Oil Company v. *United States,* 280 U. S. 390;

Bullen v. *Wisconsin,* 240 U. S. 625;

Jones v. *Helvering,* 71 Fed. (2d) 214, certiorari denied October 8, 1934.

In *United States* v. *Phellis,* 257 U. S. 156, the Court said, referring to reorganizations (p. 172):

> "In such matters, what was done, rather than the design and purpose of the participants, should be the test."

United States v. *Isham,* 84 U. S. 496, involving stamp taxes on instruments, has always been considered a controlling authority. The Court answered a contention of the Government as follows:

> "It is said that the transaction proved upon the trial in this case, is a device to avoid the payment of a stamp duty, and that its operation is that of a fraud upon the revenue. This may be true, and if not true

in fact in this case, it may well be true in other instances. To this objection there are two answers:

1. That if the device is carried out by the means of legal forms, it is subject to no legal censure. . . .

Another answer may be given to the objection more comprehensive in its character. It is this: that the adoption of a rule that the form of the instrument can be disregarded, and its real character be investigated for the purpose of determining the stamp duty, would produce difficulties and inconveniences vastly more injurious than that complained of."

Evidently, therefore, the decision of the Circuit Court was purely a matter of construction of the statute. As it said (R. 35), "the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes". But the Court's decision strikes a dissonant note, which is out of harmony with the language of the definition of reorganization (as seen under Point II), with the intent of Congress (as seen under Point III), and with the consistent regulations of the Treasury Department (as seen under Point IV).

The Circuit Court cites no direct authority for its position. It suggests comparison (R. 36) with *Lonsdale* v. *Commissioner,* 32 Fed. (2d) 537 (C. C. A., 8 Circ., April 18, 1933), in which the Court held that clause (B), pursuant to its terms, "required a transfer by a corporation", and not by third parties, and refused to ignore corporate entities, and *Prairie Oil & Gas Co.* v. *Motter,* 66 Fed. (2d) 309 (C. C. A., 10 Circ., July 13, 1933), in which, one corporation having purchased the properties or the stock of another corporation for cash, the Court held that there was no reorganization within clause (A). It regards as pertinent this Court's decision in *Pinellas Ice &*

Cold Storage Co. v. *Commissioner,* 287 U. S. 462, and its own decision in *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937, saying with respect to the construction of clause (A) of the definition of reorganization by the decisions in those cases (R. 36):

> "The violence done the literal interpretation of the words is no less than what we do here."

In *Cortland Specialty Co.* v. *Commissioner,* 60 Fed. (2d) 937 (C. C. A., 2 Circ., July 29, 1932), the Cortland Company in 1925 transferred substantially all of its properties to the Deyo Company in exchange for $76,874 in cash and $159,750 in six promissory notes of the latter Company, falling due over a period of fourteen months, and thereupon distributed such cash and notes to its stockholders and proceeded to dissolve. The Court held (1) that, even if there were a reorganization within clause (A) of the definition of reorganization, the exchange was taxable because short-term promissory notes were not "securities" within the meaning of Section 203 (b) (3) and (e) of the 1926 Act, and (2) that there was not a reorganization because there was no continuity of interest on the part of the transferor in the properties transferred. The Court said in part:

> ". . . In defining 'reorganization', section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure, but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption. Reorganization presupposes continuance of business under modified corporate forms.
>
> . . . As no stock was issued against the transfer, the conditions for an exemption were not fulfilled unless the notes, all payable within fourteen months

> of the date of the transfer, and all unsecured, can be considered 'securities' under section 203 (e). Inasmuch as a transfer made entirely for cash would not be enough, it cannot be supposed that anything so near to cash as these notes payable in so short a time and doubtless readily marketable would meet the legislative requirements."

Meanwhile, the Circuit Court of Appeals for the Fifth Circuit, in *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 57 Fed. (2d) 188 (March 29, 1932), which involved the same questions as the *Cortland* case, had gone further in limiting the definition of reorganization in clause (A), and the case went up on writ of certiorari to this Court, which in 287 U. S. 462 (January 9, 1933), affirmed the decision of the Circuit Court of Appeals. In this case the Pinellas Company on December 15, 1926, transferred 99 per cent. of its net assets to the Florida Company in exchange for $400,000 in cash and $1,000,000 in notes, secured by collateral and all falling due by April 1, 1927, and distributed to its stockholders the cash and the proceeds of the notes as they were paid, thereupon being dissolved. This Court held that the transaction was a sale for the equivalent of cash, and not an exchange for "securities", and accordingly was taxable. It was immaterial, therefore, whether or not there was a "reorganization", but the Court went on to disapprove the narrow construction of "reorganization" adopted by the Circuit Court of Appeals, saying (italics ours):

> "The court below held that the facts disclosed failed to show a 'reorganization' within the statutory definition. And, in the circumstances, we approve that conclusion. But the construction which the court seems to have placed upon clause A, paragraph (h) (1), § 203, we think is too narrow. *It conflicts with*

established practice of the tax officers and if passed without comment, may produce perplexity.

The court said—'it must be assumed that in adopting paragraph (h) Congress intended to use the words "merger" and "consolidation" in their ordinary and accepted meanings. Giving the matter in parenthesis the most liberal construction, it is only when there is an acquisition of substantially all the property of another corporation in connection with a merger or consolidation that a reorganization takes place. Clause (B) of the paragraph removes any doubt as to the intention of Congress on this point.' (57 F. (2d) 190.)

The paragraph in question directs—'The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).' The words within the parenthesis may not be disregarded. They expand the meaning of 'merger' or 'consolidation' so as to include some things which partake of the nature of a merger or consolidation but are beyond the ordinary and commonly accepted meaning of those words—so as to embrace circumstances difficult to delimit but which in strictness cannot be designated as either merger or consolidation. But the mere purchase for money of the assets of one Company by another is beyond the evident purpose of the provision, and has no real semblance to a merger or consolidation. *Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short term purchase money notes.* This general view is adopted and well sustained in Cortland Specialty Co. *v.* Commissioner of Internal Revenue (C. C. A. (2d) 60 F. (2d) 937, 939, 940). It harmonizes with the underlying pur-

pose of the provisions in respect of exemptions and gives some effect to all the words employed."

It seems clear from this Court's opinion that it definitely recognized that the question whether or not there was a reorganization did not require decision, because, even if there were a reorganization, there was no exchange of property for "securities", and that, solely because the Circuit Court of Appeals for the Fifth Circuit had seen fit to construe the definition of reorganization in clause (A), as had the Circuit Court of Appeals for the Second Circuit in the *Cortland* case, it proceeded to discuss the definition of reorganization, approving the limitation of its language to the extent and only to the extent of requiring a continuity of interest, which could be regarded as implicit in the concept of merger or consolidation under clause (A). It is important to note that, whereas clause (A) deals with mergers and similar amalgamations, clause (B) deals with segregations or corporate split-ups. The *Pinellas* and *Cortland* cases were concerned, not with clause (B), but with clause (A) of the definition of reorganization, the language of which was more susceptible to interpretation. The continuity of interest required by those decisions under clause (A) is not only expressly prescribed and limited by clause (B), but is present in this case, where immediately after the transfer the transferor corporation or its stockholders were in control of the transferee corporation.

The dissolution of the Averill Corporation after the transfer of the Monitor stock to the Averill Corporation and after the distribution of the Averill stock to Mrs. Gregory could not and did not vitiate the reorganization already accomplished. Clause (B) of the definition of reorganization requires control only "immediately" after the trans-

fer (Appendix, p. 55). In *Bamberger* v. *Commissioner*, 27 B. T. A. 785 (reversed and remanded on stipulation, 67 Fed. (2d) 983), both parties conceded the existence of reorganizations where two out of three corporations, to which another corporation had transferred portions of its assets on June 21, 1929, were dissolved on July 16, 1929. In *Hesslein* v. *Commissioner*, 21 B. T. A. 61, affirmed 53 Fed. (2d) 1081, the segregation of the Reading properties was held to have been a reorganization in the case of a stockholder who sold his right to receive the stock of the controlled corporation even before it was distributed to him. In *Federal Grain Corporation* v. *Commissioner*, 18 B. T. A. 242, 248, and *Schmieg, Hungate & Kotzian, Inc.* v. *Commissioner*, 27 B. T. A. 337, 342, momentary control was considered sufficient. See also *Evans Products Co.* v. *Commissioner*, 29 B. T. A. 992, *supra* (p. 38). So far as counsel knows, there are no decisions to the contrary.

In addition to the lack of any support in decided cases for the novel theory advanced by the Circuit Court in the present case, the canons of statutory construction all require an opposite conclusion.

It has often been held that the words of a statute should be taken in their plain popular meaning, and that unambiguous language permits no resort to extraneous considerations. Decisions in support of this proposition are cited under Point II above.

Where a statute has had a consistent practical construction, and Congress has repeatedly re-enacted the same language, the conclusion is required that such construction was not inconsistent with the intent of the statute. Decisions in support of this proposition are cited under Point IV above.

CONCLUSION

The decision of the Board of Tax Appeals was correct and that of the Circuit Court of Appeals was erroneous.

It is not an exaggeration to say that the decision of the Circuit Court in this case is revolutionary. Ever since the first enactment in the Revenue Act of 1924, and the continuance in subsequent acts with minor changes, of elaborate, precise and comprehensive provisions governing the taxability of exchanges and reorganizations, taxpayers and their counsel, and until recently the Treasury Department, have acted and advised in reliance upon the plain propositions of the statute, regarding as non-taxable, transactions within the scope of the language given its ordinary significance, and regarding as taxable, transactions outside such scope, irrespective of motives and purposes, whether of tax avoidance or otherwise. It made no difference, because the statute furnished its own definition, that many transactions within the statute were not reorganizations to a banker or to the man in the street or in the ordinary legal sense, which usually connotes the compulsion of financial difficulties.

But now, under the decision of the Circuit Court, the purpose of the transaction would become more important than what was actually done, and for the provisions of the statute would be substituted the guess of each court in each case as to whether the ultimate object of the taxpayers was within the unexpressed intent of Congress. No reorganization, whether under the 1934 Act or earlier Acts, could escape the test. It would be impossible for taxpayers safely to undertake readjustments of their affairs, when a strict compliance with the statutory provisions as they are written would be as likely to prove a trap

as a refuge. No two courts could be counted on to agree on what were permissible purposes, once having abandoned the safe and sure ground of the statutory definition.

Probably the respondent will contend that a reversal of the decision of the Circuit Court would cause a serious loss of revenue to the Government. It is just as likely to be true that an affirmance of the decision below would cause a serious loss of revenue. No one in or out of the Treasury Department can do more than speculate. A great many reorganizations which were no more "germane to the venture in hand" than the reorganization here involved, and equally as "ephemeral", have been consummated during the decade or more that the reorganization provisions have been in effect, and until quite recently practically all of these corporate readjustments have been accepted by the Treasury Department as constituting tax-free reorganizations. If the decision below should be affirmed, the taxpayers involved in these false reorganizations, having escaped taxes thereon because of the Treasury Department's misconstruction of the statute, would now be in a position to obtain further benefits by showing that the transactions were not reorganizations. On the subsequent sale of property received in such transactions, as well as for the computation of depreciation and depletion, the taxpayers would be entitled to a cost basis of market value at the date of the readjustment, and would not be limited to the cost to the transferor. In the case of readjustments in years not yet barred by the statute of limitations, it would often be more advantageous to pay taxes at the lower corporate rates for such years, than to be taxed at the higher present rates on subsequent sales of the property acquired through the readjustments. As the reorganization provisions were enacted for the purpose, not only of deferring taxation of gains in formal intercorpo-

rate transactions, but also of deferring recognition of losses until they should be actually realized by sale, in many instances of reorganizations meeting every objective, but failing in the subjective, test the taxpayers would be in a position to claim the deduction of substantial losses.

Simplicity, equality and certainty are universally regarded as desirable objectives for tax laws. A statutory provision which is construed as dependent upon motives, although it does not say so, scarcely makes for simplicity. The different taxation of two transactions identical in what was done, although with unlike motives, scarcely makes for equality. The inability of lawyers with any confidence to advise their clients that contemplated reorganizations are within or without a statute framed in the plainest language utterly destroys the certainty which Congress expressly intended. Taxpayers want, and the Treasury Department should want, not an attempt to do equity in each individual case, which is impossible in a tax law, but simplicity, equality and, above all, certainty.

The Circuit Court's rule not only is unwarranted by the language of the statute, by the expressed intent of Congress, by the consistent regulations and rulings of the Treasury Department, and by the decisions of the Courts, but also is impossible of administrative application. The decision below should be reversed.

Respectfully submitted,

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November 1, 1934.

APPENDIX

Revenue Act of 1928

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) Computation of gain or loss.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized. . . .

(d) Recognition of gain or loss.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purpose of this title, shall be determined under the provisions of section 112.

SEC. 112. RECOGNITION OF GAIN OR LOSS. . . .

(b) Exchanges solely in kind.— . . .

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. . . .

(g) Distribution of stock on reorganization.—If there is distributed in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) Same—effect on future distributions.—The distribution in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) Definition of reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) Definition of control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of

the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) Property acquired after February 28, 1913.—

. . .

(7) TRANSFERS TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer; . . .

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112 (g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; . . .

SEC. 115. DISTRIBUTIONS BY CORPORATIONS. . . .

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts

distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. . . .

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

This case presents the question whether a reorganization occurred within the meaning of Section 112 (i) (1) of the Revenue Act of 1928 where a new corporation was formed for the sole purpose of acquiring a portion of the assets of an existing corporation and distributing such assets to the sole stockholder of the transferring corporation in such manner as to vest absolute ownership of these assets in the stockholder with the minimum of resulting tax liability upon the stockholder and her corporation.

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We submit that the Circuit Court of Appeals correctly held that this transaction did not constitute a reorganization within the meaning of the statute since it was not the legislative intent to postpone the recognition of gain or loss where the alleged reorganization was not undertaken for reasons germane to the continuing conduct of the business venture but was conceived and used merely for the purpose of avoiding taxes which would otherwise result.

We concur in the view of the court below that Congress intended to encourage corporate reorganizations for business purposes but not to afford a present exemption where the purpose was solely tax avoidance upon a distribution of assets, and that the statute may be construed by reference to its purpose, as was done by this Court in *Pinellas Ice Co.* v. *Commissioner,* 287 U.S. 462.

But as the petition points out, the question presented is of public importance. In the interest of corporate taxpayers generally as well as for the guidance of the administrative officials, it is extremely desirable to secure an authoritative decision of this Court upon the question in view of the fact that a transaction alleged to be a reorganization may meet with the literal provisions of the statute and yet not come within the interpretation for which we contend, based upon the legislative intent.

While there is no direct conflict of decisions upon the question, in *B. B. Jones et al.* v. *Commissioner,*

not yet reported but found in 343 C.C.H., p. 9835, the United States Court of Appeals for the District of Columbia allowed the deduction of a loss by the stockholders upon the sale of bonds to their corporation, although it was evident from the nature of the transaction and the fact that the sellers controlled the buyer that the loss was fictitious and a sham. Here the court properly held that the creation of the Averill Corporation merely for the purpose of vesting ownership of the Monitor stock in the taxpayer was a sham reorganization, not to be recognized as one in fact. To this extent the decisions are inconsistent. A petition for a writ of certiorari has been filed by the Government in the *Jones* cases (Nos. 225–228).

While we believe that the decision of the court below is correct, in view of the importance of the question and the desirability of securing an authoritative rule for the future guidance of administrative officials as well as taxpayers, we do not oppose the granting of the writ.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.

JULY 1934.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 8–11) is reported in 27 B. T. A. 223. The opinion of the Circuit Court of Appeals (R. 33–37) is reported in 69 F. (2d) 809.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 26, 1934. (R. 37–38.) The petition for a writ of certiorari was filed June 23, 1934, and was granted October 8, 1934. (R. 39.) The

jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where the sole stockholder of a corporation, actuated solely by a desire to sell and receive the proceeds of certain surplus assets of the corporation with payment of the least possible tax, causes a new corporation to be organized and the assets to be transferred to it in return for the issuance of all of its stock to said stockholder, and immediately following the transfer the new corporation is dissolved and the assets are distributed to the stockholder, does such transaction come within the reorganization provisions of the Revenue Act of 1928, so that the stockholder is taxable only on the basis of profit realized by her upon the liquidation of the new company or does it amount to payment of a taxable dividend by the original corporation?

STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 34–40.

STATEMENT

The following material facts are taken from the opinion of the Board of Tax Appeals (R. 8–9) as supplemented by a statement of the petitioner's attorney made before the Board of Tax Appeals (R. 18–20) and the evidence at the hearing (R. 26–30):

The petitioner was the owner of 5,000 shares of the United Mortgage Corporation, constituting all of its outstanding stock. Of these, 3,300 shares had been purchased between October 1, 1920, and December 16, 1921, at a cost of $180,000, and 1,700 shares between January 12, 1927, and January 3, 1928, at a cost of $170,000. The United Mortgage Corporation had among its assets 1,000 shares of the Monitor Securities Corporation (R. 13, 18), which represented a part of the surplus of the United Mortgage Corporation, and which cost it $10,413.07 when purchased in 1922 (R. 22, 25).

"In 1928 certain bankers began negotiations for the purchase of all of the stock of the Monitor Securities Corporation * * *. It became evident that, if the United Mortgage Corporation sold the stock, double taxation would accrue; that is, a tax to the corporation and a tax to Mrs. Gregory on the distribution to her as a stockholder, as a dividend. She, in conference with attorneys, frankly sought a way to avoid the payment of a double tax." (R. 18.)

A plan was devised by petitioner to transfer the Monitor stock to a new corporation and then dissolve the new corporation and deliver the Monitor stock to the taxpayer and let her sell it.

In pursuance of this plan, the Averill Corporation was organized under Delaware law on September 18, 1928, by petitioner (R. 9.) On or about September 21, 1928, the United Mortgage Corpora-

tion transferred to the Averill Corporation the 1,000 shares of Monitor stock and the Averill Corporation issued all of its capital stock to the petitioner. (R. 19, 25.) Averill Corporation "thereafter immediately" on the same day began proceedings for its dissolution, which were concluded September 24, 1928. On that date the Averill Corporation liquidated and dissolved and distributed to the petitioner the 1,000 shares of Monitor stock constituting all of its assets. "Immediately thereafter" on the same date as the distribution, the petitioner sold the Monitor shares for $133,333.33. The distribution of the 1,000 shares of Monitor stock to petitioner "occurred *at the same time* as the sale of said stock by her." (R. 19; italics ours.)

The value of the Monitor stock on the date of distribution to and sale by the petitioner was $133,333.33. The Averill Corporation transacted no business. It was never contemplated it should transact any business. It had no books of account, "none being deemed necessary" (R. 24), as it was not to do any business, but to be immediately dissolved upon receiving the Monitor stock. The sole purpose of its organization was to enable the petitioner to save income taxes which she might otherwise be required to pay, if she carried through the transaction individually. (R. 18, 29.)

"The entire transaction in the formation of Averill and its dissolution was carried out and supervised by counsel for Mrs. Gregory and on their advice." (R. 29.)

In her return for the calendar year 1928 the petitioner treated the several transactions as governed by the reorganization provisions of the Revenue Act of 1928, and returned as capital net gain from the sale price of $133,333.33 the amount of $76,007.88 upon an apportioned cost basis of $57,325.45. (R. 23.)

The Commissioner of Internal Revenue determined a deficiency of $10,678.16 by including the value of the Monitor stock, or $133,333.33, in the petitioner's income as an ordinary dividend subject to surtax and eliminating from income the capital gain of $76,007.88 theretofore reported by the petitioner. (R. 20.) On appeal the Board of Tax Appeals held that the petitioner realized a taxable gain of $76,007.88 on liquidation of the Averill Corporation measured by the difference between $133,333.33, the value of the Monitor Securities Corporation stock, and $57,325.45, the cost attributed to the stock of the Averill Corporation in the petitioner's hands. (R. 11.) The Circuit Court of Appeals, reversing the Board, held that the transfer of the Averill Corporation stock to the petitioner in consideration of the receipt of the Monitor Securities Corporation stock from the United Mortgage Corporation was not made pursuant to a plan of reorganization within the meaning of Section 112 (g) and (i) of the Revenue Act of 1928 and that the value of the Averill Corporation stock received by the petitioner was taxable in her hands as a dividend. (R. 33, 37.) The resulting defici-

ency under the decision of the Circuit Court of Appeals is the same in amount as that determined by the Commissioner.

SUMMARY OF ARGUMENT

If Section 112 (g) and (i) were not a part of the Revenue Act of 1928 the petitioner would be taxable upon the value of the Averill Corporation stock as a dividend. Since the petitioner claims a present exemption or an exception to the usual mode of taxation, she must bring herself squarely within the statutory provisions. When the statutory words are considered in the light of the legislative purpose it will be seen that the petitioner's case is not included. An examination of the legislative history of the reorganization provisions clearly indicates that Congress intended to afford a present exemption only where a corporate readjustment is made for an ordinary business purpose having some relation to the continuation of a business enterprise. In construing the provisions the courts have observed this underlying idea. There are persuasive reasons for applying to the reorganization provisions the principle that the literal language of the statute is to be interpreted in the light of the purposes intended to be accomplished. If this should not be done the purpose of the legislature would be defeated to an appreciable extent. In other cases the courts have narrowed the language of these provisions by reference to their purpose.

So interpreted it is plain that the petitioner's situation is not embraced within the provisions upon which she relies. The Averill stock was not distributed pursuant to a plan of reorganization, since there existed no purpose germane to the business. Accordingly the Averill stock was taxable to petitioner as a dividend.

Congress has evidenced a clear intent to tax all distributions such as that here, made by a corporation from its earnings or profits accumulated since February 28, 1913. Looking at the substance of the transaction it is apparent that the Averill Corporation was a mere device or instrumentality controlled by the petitioner and formed for one purpose only—to distribute earnings of the United Mortage Corporation to petitioner free from the tax intended to be imposed. In such a situation it is proper to look through the agency used and to determine the case upon the real substance of the transaction. This Court and other courts have so held. Applying this principle, it must follow that the Monitor stock was distributed as a dividend to the petitioner through the instrumentality of the Averill Corporation and its value was taxable to her as a dividend.

ARGUMENT

I

THE DISTRIBUTION OF THE AVERILL CORPORATION STOCK TO THE PETITIONER WAS NOT MADE PURSUANT TO A PLAN OF REORGANIZATION WITHIN THE MEANING OF SECTION 112 (G) OF THE REVENUE ACT OF 1928, AND THE VALUE OF THE STOCK SO RECEIVED WAS TAXABLE TO THE PETITIONER AS AN ORDINARY DIVIDEND

In the absence of the provisions of Section 112 (g) and (i) of the Revenue Act of 1928 (*infra*, p. 35), there could be no doubt but that the petitioner would be held to have been the recipient of a taxable dividend as a result of the distribution of the Averill Corporation stock. This Court has held under taxing statutes containing no such exemption provisions that such distributions constitute taxable dividends (*United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176), and Sections 22 (a) and 115 (a) and (b) of the Revenue Act of 1928 (*infra*, pp. 34, 37) include in a stockholder's income distributions made from corporate earnings accumulated after February 28, 1913. By including in the petitioner's taxable income as a dividend the value of the Monitor stock, or $133,333.33, the Commissioner determined that the earnings of the United Mortgage Corporation since February 28, 1913, were at least this amount.

The Monitor stock was purchased by the United in 1922 for $10,413.07 and it was carried on the books of the United at this price. (R. 25.) Referring to the transfer of the Monitor stock on

September 21, 1928, the record discloses a stipulation that:

"On the books of United Mortgage Corp., the transaction was entered as a charge to surplus for $10,413.07 and a credit to the investment asset account 'Monitor Securities Corporation' stock for $10,413.07, which closed out the latter account. The surplus affected was accumulated after February 28, 1913." (R. 25–26.)

At that time the United Mortgage Corporation had assets of $814,064.25, which included the Monitor stock of the value of $133,333.33. It had 5,000 shares of capital stock, which cost petitioner $350,000.00. (R. 23.)

The petitioner contends that her situation comes within the literal language of Section 112 (g) and (i) of the Revenue Act of 1928 and that accordingly she did not receive a taxable dividend. We submit that the court below properly held that these subsections, properly interpreted, do not embrace her case.

Section 112 (g), *infra,* provides that "If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized." A "reorganization" is defined in Section

112 (i) (1) (B) to mean "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred."

Since in the absence of these provisions the petitioner would undoubtedly be compelled to pay a tax on the whole amount of the dividend, it is apparent that she is claiming an exemption or an exception to the usual mode of taxation. A taxpayer who claims an exemption must bring himself squarely within the statutory terms and the rule is equally applicable to a taxpayer who claims the benefit of exceptional treatment. *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182, 187. Where a provision grants an exemption from the full rate of taxation doubts must be resolved against the taxpayer. *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235.

It was incumbent upon the petitioner to show that the transaction constituted a "reorganization" within the meaning of the Act, that she received stock from a party to the reorganization, and that this distribution was made "in pursuance of a plan of reorganization." She contends that her case conforms with the literal language of the statute, regarding as immaterial the fact that the conformance was at most transitory; that the purpose of her plan was merely to effect the distribution of a single corporate asset to her as sole stockholder free from a tax on dividends; and that there

was no intention to carry on the business through a changed corporate structure. We contend that when the words of the statute are considered in the light of its obvious purpose, it will be demonstrated that the petitioner's case is not included.

An examination of the legislative history of the so-called reorganization provisions of the Revenue Acts demonstrates that they were intended to exempt only those ordinary business transactions where, on a readjustment of corporate enterprises, a continuing interest is held in the business. The Revenue Act of 1918 (c. 18, 40 Stat. 1057), Section 202 (b), contained the first enactment in this respect. It provided that no gain or loss should be recognized where, in connection with a reorganization, a person received in place of stock or securities owned by him, new stock or securities of no greater par value. As the Senate Finance Committee's report shows, the provision was inserted to free purely paper gains from tax. S. Rep. No. 617, 65th Cong., 3d Sess., p. 5. The Revenue Act of 1921 (c. 136, 42 Stat. 227), in Section 202 (c) (2), incorporated a definition of the word "reorganization" and provided that no gain or loss should be recognized, whether or not the new stock or securities received were of a greater par value. In discussing the amendments the House Ways and Means Committee stated, in part (H. Rep. No. 350, 67th Cong., 1st Sess., p. 10):

> The preceding amendments, if adopted, will, by removing a source of grave uncer-

> tainty, not only permit business to go forward with the readjustments required by existing conditions but will also considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges.

Similar language is contained in the report of the Senate Finance Committee. See S. Rep. No. 275, 67th Cong., 1st Sess., pp. 11–12.

The Revenue Act of 1924 was the first Act which contained a provision similar to Section 112 (g) of the Revenue Act of 1928, upon which the petitioner relies. See Section 203 (c), Revenue Act of 1924, c. 234, 43 Stat. 253, 256 (U. S. C., Title 26, Sec. 934). In discussing certain additional exemptions on reorganization added in that Act, the Ways and Means Committee of the House said (H. Rep. No. 179, 68th Cong., 1st Sess., p. 13):

> Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization *in order that ordinary business transactions will not be prevented on account of the provisions of the tax law.* If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation. (Italics ours.)

The reorganization provisions of the Revenue Act of 1924 have been reenacted in substantially

the same form under the Revenue Act of 1926, Section 203 (c. 27, 44 Stat. 9, 12; U. S. C. App., Title 26, Sec. 934), and the Revenue Act of 1928, Section 112, *infra,* p. 35, and the committee reports under the latter Acts throw no further light upon the legislative purpose. We submit that the history of these provisions clearly indicates that Congress intended to afford a present exemption only where the corporate readjustment is made for an ordinary business purpose having some relation to the continuation of a business enterprise, with a change purely formal in nature. The court below aptly stated this purpose in its opinion as follows (R. 35):

> But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the shareholders' taxes is not one of the transactions contemplated as corporate "reorganizations."

In construing the reorganization provisions the courts have observed the underlying idea that they were intended to facilitate the continuation of a corporate business where the change was one in form only, by exempting such readjustments from tax at the time they were made. In *Lonsdale* v. *Commissioner,* 32 F. (2d) 537 (C. C. A. 8th), certiorari denied, 280 U. S. 575, in considering the

provisions of the Revenue Act of 1924, the court said (p. 539):

> This section obviously has reference either to a complete reorganization of the original corporation by a transfer of its entire assets to another, then existing or newly organized, or to a transfer of a part of the assets in such manner that the corporations may thereafter be under one control and may be operated substantially as one in the prosecution of their business. It cannot properly, and does not, we think, refer to the organization of an independent company—although with substantially the same stockholders and officers—which is authorized by its charter to transact business and engage in dealings which are prohibited to the original corporation. * * *

In *Prairie Oil & Gas Co.* v. *Motter,* 66 F. (2d) 309 (C. C. A. 10th), the court used the following language (pp. 310–311):

> Reading all the sections exempting from tax transfers made to accomplish reorganizations, the congressional intent is plain. Where a merger or consolidation takes place, and the stockholders retain their interest in the corporate properties, there is no realized gain; there is but a substitution of their certificates of participation. Such transfers were exempted from tax so that such reorganizations should not needlessly be impeded. * * *

In another case, *Cortland Specialty Co.* v. *Commissioner,* 60 F. (2d) 937, certiorari denied, 288

U. S. 599, which involved a claim of corporate reorganization, the court below discussed the purpose of the statute as follows [1] (p. 940):

> Its purpose was to relieve those interested in corporations from profits taxes in cases where there was only a change in the corporate form in which business was conducted without an actual realization of any gain from an exchange of properties. When describing the kind of change in corporate structure that permits exemption from these taxes, section 203 does not disregard the necessity of continuity of interests under modified corporate forms. * * *. In defining "reorganization", section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure, but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption. Reorganization presupposes continuance of business under modified corporate forms.

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[1] The word "reorganization", as it is commonly used, connotes the idea of a continuity of interests in a business under modified or changed corporate form. See Fletcher, Cyclopedia Corporations—Permanent Edition (1932), Vol. 15, pp. 268–271. We do not imply that the word "reorganization" as it is used in the statute is necessarily limited to a definition gathered from other sources. But the nature of a reorganization as it is commonly understood is, we believe, important in determining the legislative intent where the statutory language does not conflict with the general commercial understanding.

We submit that the literal language of the statute must be considered and construed in the light of the purposes intended to be accomplished. This Court has declared that in construing a statute it is not always confined to a literal reading and may consider its object and purpose, the things with which it is dealing, and the condition of affairs which led to its enactment, so as to effectuate, rather than destroy, the spirit and force of the law which the legislators intended to enact. *American Tobacco Co.* v. *Werckmeister*, 207 U. S. 284, 293. The intention of the law-making power will prevail even against the letter of the statute. *Fleischmann Co.* v. *United States*, 270 U. S. 349, 360; *Hawaii* v. *Mankichi*, 190 U. S. 197, 212; *Petri* v. *Commercial Bank*, 142 U. S. 644, 650. In *Holy Trinity Church* v. *United States*, 143 U. S. 457, an alien, pursuant to a contract, came to the United States and entered into the service of the church as rector. The Circuit Court ~~of Appeals~~ held that the act of the church in inducing the alien to enter the country came within the language of an Act of Congress providing that it should be unlawful to assist or encourage in any way the importation or migration of any alien "to perform labor or service of any kind in the United States." While conceding that the act of the church came within the letter of the statute, this Court held that it was not within the legislative intent and reversed the Circuit Court ~~of Appeals~~, saying in part (p. 459):

> It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers. This has been often asserted, and the reports are full of cases illustrating its application. This is not the substitution of the will of the judge for that of the legislator, for frequently words of general meaning are used in a statute, words broad enough to include an act in question, and yet a consideration of the whole legislation, or of the circumstances surrounding its enactment, or of the absurd results which follow from giving such broad meaning to the words, makes it unreasonable to believe that the legislator intended to include the particular act. * * *

In the recent case of *Helvering* v. *N. Y. Trust Co.*, 292 U. S. 455, this Court considered Section 206 (a) (6) of the Revenue Act of 1921, defining "capital assets" to be "property acquired and held by the taxpayer for profit or investment for more than two years". This Court conceded that if the words alone should be looked to, the trustee's situation did not meet the definition, since it was a taxpayer and had held the stock less than two years prior to its sale. But in construing the definition in the light of the legislative history and of other provisions of the Act, a majority of the Court held that the period during which the trustor held the property should be added to the trustee's holding

period, thus bringing the situation within the definition. The opinion states in part (pp. 464–465):

> The rule that where the statute contains no ambiguity, it must be taken literally and given effect according to its language is a sound one not to be put aside to avoid hardships that may sometimes result from giving effect to the legislative purpose. *Commissioner of Immigration* v. *Gottlieb*, 265 U. S. 310, 313. *Bate Refrigerating Co.* v. *Sulzberger*, 157 U. S. 1, 37. But the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished. Speaking through Chief Justice Taney in *Brown* v. *Duchesne*, 19 How. 183, this court said (p. 194): "It is well settled that, in interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the Legislature, as thus ascertained, according to its true intent and meaning." Quite recently in *Ozawa* v. *United States*, 260 U. S. 178, we said (p. 194): "It is the duty of this Court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance, but if this leads to an unreasonable result plainly at variance with the policy

> of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment and inquire into its antecedent history and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail." And in *Barrett* v. *Van Pelt,* 268 U. S. 85, 90, we applied the rule laid down in *People* v. *Utica Ins. Co.,* 15 Johns. 358, 381, that "a thing which is within the intention of the makers of a statute is as much within the statute as if it were within the letter, and a thing which is within the letter of the statute, is not within the statute, unless it is within the intention of the makers."

There are persuasive reasons for applying these principles to the reorganization provisions of the Revenue Acts. In enacting a vast and intricate scheme of taxation there are necessarily many complications unsuspected by the framers of the statute. It is too much to expect that the words of the Act can definitely circumscribe the bounds of every business plan; in many cases they can merely express the general intention of the law-making body. "Generally, questions as to the meaning intended do not arise until the language used is compared with the facts or transactions in respect of which the intent and purpose are to be ascertained." *Helvering* v. *N. Y. Trust Co., supra,* p. 465. It is obvious that the reorganization provisions were enacted for a definite and limited purpose. They

are equitable in nature and are designed for the relief or encouragement of those who, in a *bona fide* readjustment of corporate enterprises, receive stock or securities which, though normally taxable, represent no real gain to the recipient but merely evidence continued participation in a revised business structure. To permit their benefits to be obtained by those who have no such plan in view but who are merely making temporary use of a new corporation to place themselves within the literal language of the statute, would defeat to an appreciable extent the intention of the framers of the Act.

As the court below observed (R. 36) the language of the reorganization statutes has been narrowed by reference to the purposes of their enactment in other cases. In *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 287 U. S. 462, the claimed reorganization came within the literal words of Section 203 (h) (1) (A) of the Revenue Act of 1926, since one corporation had acquired all the property of the other. This Court agreed with the court below that this was not a "reorganization", basing its conclusion upon the ground that it was beyond the evident purpose of the statute to include a plan of action where a seller of property acquired no more definite interest in the affairs of the purchasing company than that incident to ownership of its short-term purchase-money notes. A decision of similar effect was rendered by the Circuit Court of Appeals for the Second Circuit in *Cortland Specialty Co.* v. *Commissioner, supra.* To the same effect is the

decision of the Circuit Court of Appeals for the Tenth Circuit in *Prairie Oil & Gas Co.* v. *Motter, supra,* where the Collector was contending for a literal interpretation of the Act. The court refused to adopt the literal interpretation and sought out the Congressional intent.[2]

The facts of this case indicate clearly that there was no "reorganization" or "plan of reorganization" within the meaning of the words of the statute when interpreted in the light of the legislative intent. Shortly before the various transfers were made certain bankers had begun negotiations for the purchase of the Monitor stock and it is admitted that the whole transaction was undertaken only for the purpose of reducing in the best possible way the taxes which would result from the sale of this stock and the distribution of the proceeds to the petitioner, the sole stockholder of the United Mortgage Corporation. (R. 19, 29.) In pursuance of this objective, the Averill Corporation was formed on September 18, 1928. On September 21, 1928, the United Mortgage Corporation transferred the Monitor stock to the Averill Corporation and at

[2] In certain recent decisions the Board of Tax Appeals has also declined to follow the strict literal language. See *Minnesota Tea Co.* v. *Commissioner*, 28 B. T. A. 591; *John J. Watts* v. *Commissioner*, 28 B. T. A. 1056; *Central National Bank of Lincoln, Nebraska*, v. *Commissioner*, 29 B. T. A. 719; *A. L. Miller* v. *Commissioner*, 29 B. T. A. 1061; and see *The Ballwood Co.* v. *Commissioner*, 30 B. T. A. 644, in which the Board relied to some extent upon the decision of the court below in the instant case.

the same time the Averill Corporation issued all of its stock to the petitioner, and immediately began proceedings for dissolution, which were concluded on September 24, 1928; and it then distributed the Monitor shares to the petitioner and immediately thereafter the petitioner sold the stock. (R. 19.)

The transfer was not a reorganization and the Averill shares were not distributed in pursuance of a plan of reorganization.

In commenting on this aspect of the case the court below said: "The purpose of the section is plain enough; men engaged in enterprises—industrial, commercial, financial, or any other—might wish to consolidate, or divide, to add to, or subtract from, their holdings. Such transactions were not to be considered as 'realizing' any profit, because the collective interests still remained in solution." The court stated that it was plain that the readjustment must be undertaken for reasons germane to the conduct of the venture in hand, and that to dodge the shareholders' taxes was not one of the transactions contemplated as corporate "reorganizations." (R. 35.)

The court further said the steps taken "were not what the statute means by a 'reorganization', because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect." (R. 37.)

"Reorganization presupposes continuance of business under modified corporate forms." *Cortland Specialty Co.* v. *Commissioner, supra,* p. 940, cited with approval by this Court in *Pinellas Ice & Cold Storage Co.* v. *Commissioner, supra.*

It was never contemplated that the Averill Corporation should do any business, but on the contrary it was formed for the sole purpose of being dissolved just as soon as the Monitor stock should be transferred to it so that petitioner could get the stock and sell it as agreed upon, before it was organized. This plan was carried out literally and while the Averill charter was obtained a few days before the Monitor stock was transferred, yet just as soon as the Averill Corporation got this stock, or, in the language of the record, "thereafter immediately" (R. 19) it began proceedings for its dissolution. So the Averill Corporation was a going concern only for an instant of time. Under these admitted facts, we do not see how the Board of Tax Appeals could be of the opinion that this was a "bona fide use of the corporate device" in a plan of reorganization prescribed by statute.

Instead of being a plan of reorganization it was simply a plan to use the new corporation as a means of getting the Monitor stock in the hands of the petitioner so that she could sell it. "It is not disputed," said the court below, "that all these steps were part of one purpose to reduce taxes, and that the Averill Corporation, which was in existence for only a few days, conducted no business and was

intended to conduct none, except to act as conduit for the Monitor shares in the way we have described." (R. 34.)

All the steps taken were in pursuance of a plan devised by the attorneys for the petitioner, not for the purpose of effecting a reorganization, but admittedly for the sole purpose of avoiding payment of income taxes. "The entire transaction in the formation of Averill and its dissolution was carried out and supervised by counsel for Mrs. Gregory and on their advice." (R. 29.)

When the plan had been carried out, a few days after the transaction was begun, the United Mortgage Corporation continued as before to be the only corporation in existence, the petitioner continued to hold all its shares and the business enterprise remained unaffected, except that an asset had been transferred from corporate surplus to the petitioner for the purpose of sale by her. Manifestly there was no continuation of the business enterprise merely in changed corporate form. It is apparent that the whole transaction was undertaken, not for any purpose germane to the business, but solely to avoid taxes upon the disposition of an asset. A provision extending relief to transfers which are incidental to a formal change in the corporate structure of a business, undertaken for business reasons, cannot apply to a case such as this where the transfer was merely incidental to and part of a distribution of a portion of the accrued profits of a business to its sole stockholder.

Moreover, in order to be free from tax under Section 112 (g) of the 1928 Act the distribution must be made "in pursuance of a plan of reorganization". The plan here was not one for the reorganization of a business enterprise; it had as its sole purpose the payment of a dividend free from tax. It was not a plan of reorganization at all, but a plan for distribution and sale of a corporate asset with the least possible resulting tax. It did not contemplate that the Averill Corporation should continue to exist and operate as part of a revised corporate structure. That corporation was to act only as a temporary agency in making the complete transfer. The transfer of assets to the new agency and the immediate dissolution of that agency were but integral parts of the single preconceived plan for distributing the Monitor stock to the petitioner as her separate property for the purpose of immediate sale. All the steps of the plan must be considered in determining whether it is a "plan of reorganization". *Prairie Oil & Gas Co.* v. *Motter, supra; West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77 (C. C. A. 10th). When so considered in this case it is evident that the distribution was not pursuant to a plan of reorganization within the meaning of Section 112 (g) of the Act and the petitioner is taxable, as the court below held, upon the value of the Averill Corporation stock as a dividend.

While this was not the theory of the Commissioner in determining the tax the result is the same,

since the value of the Averill Corporation stock was the same as the value of the corporation's sole asset, namely, the stock of the Monitor Corporation. The correct amount of the deficiency is the controlling factor and not the method by which it was determined. *Hughes* v. *Commissioner,* 38 F. (2d) 755, 757 (C. C. A. 10th); *Hurwitz* v. *Commissioner,* 45 F. (2d) 780 (C. C. A. 2d). We submit that the court below was correct in holding that the deficiency determined by the Commissioner should be sustained.

II

IN SUBSTANCE THERE WAS A DISTRIBUTION OF THE MONITOR SECURITIES CORPORATION STOCK THROUGH THE AGENCY OF THE AVERILL CORPORATION AND THE VALUE OF THE STOCK SO RECEIVED REPRESENTED A TAXABLE DIVIDEND TO THE PETITIONER

Congress has evidenced a clear intention to tax a stockholder upon all distributions made from earnings or profits of a corporation accumulated since February 28, 1913. It has so provided in Section 115 (a) of the Revenue Act of 1928 (*infra,* p. 37). To make doubly sure that the intended tax will result it has provided in Section 115 (b) of the same Act, *infra,* that for the purpose of the tax every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits. And Section 115 (g) of the Act was enacted to tax any amount distributed by a cancellation or redemption of stock when it was essentially equivalent to the distribution of a taxable dividend. As stated heretofore,

the value of the Monitor stock must be held to constitute earnings or profits of the United Mortgage Corporation since the petitioner failed to show that the surplus profits of the corporation were less than $133,333.33, the value of the stock at the time of distribution.

It is quite evident that the sole purpose of the formation of the Averill Corporation was to distribute the Monitor stock to the petitioner without incurring the stockholder's tax on the distribution. The Averill Corporation was formed, it received and distributed the stock and then vanished from the scene by dissolution, all within not more than six days. In substance the transaction was a distribution to the petitioner through a temporary agency called into existence for this purpose alone. As the court below aptly observed (R. 34), the Averill Corporation was intended to act only as a "conduit" for the transfer of the Monitor shares to the petitioner.

As a general rule a corporation and its stockholders are deemed separate entities, but the rule is subject to the qualification that the separate entity may be disregarded in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights. *New Colonial Ice Co.* v. *Helvering,* 292 U. S. 435, 442. We do not contend that the existence of the Averill Corporation need be disregarded for all purposes. As the court below observed (R. 37), the corporation had a juristic per-

sonality, whatever the purpose of its organization. But we do contend that, looking to the substance of the transaction, it is apparent that the Averill Corporation was a mere device or instrumentality formed and availed of solely to avoid a tax which was clearly intended to be imposed, and that the corporation should be so regarded for the purposes of the tax.

It will be noted that only one interest was involved. All of the stock of both United Mortgage Corporation and Averill Corporation was owned by the petitioner and the acts of these corporations were entirely subject to her dictation. The Averill Corporation was formed solely for a single purpose of the petitioner and was merely her *alter ego*. In such cases the intermediate corporation has frequently been regarded as a mere agency or channel through which to pass the property. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330; *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71; *Labrot* v. *Burnet,* 57 F. (2d) 413 (App. D. C.); *Hamilton Ridge Lumber Sales Corp.* v. *Wilson,* 25 F. (2d) 592 (C. C. A. 4th). And see *Coudon* v. *Tait,* 56 F. (2d) 208 (Md.), affirmed, 61 F. (2d) 904 (C. C. A. 4th), certiorari denied, 289 U. S. 733. When a corporation so controlled is created or used to avoid or circumvent a statute the substance has been treated as of paramount importance without regard to the effect of the intervening agency. Cf. *United States* v. *Lehigh Valley R. R. Co.,* 220 U. S. 257, 273; *Chicago, M. & St. P. Ry.* v. *Minn. Civic Ass'n.,*

247 U. S. 490. In the latter case the Court said (p. 501):

> While the statements of the law thus relied upon are satisfactory in the connection in which they were used, they have been plainly and repeatedly held not applicable where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose, as in this case, of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company or companies. *United States* v. *Lehigh Valley R. R. Co.*, 220 U. S. 257, 273, and *United States* v. *Delaware, Lackawanna & Western R. R. Co.*, 238 U. S. 516. In such a case the courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.

We submit that the principle should be applied here since the only purpose of creating the Averill Corporation was to distribute an asset of the United Mortgage Corporation to the petitioner, its sole stockholder, in such manner as to avoid a tax clearly intended to be imposed.

In certain other cases the courts have refused to be blinded by the mere form a transaction was made to take and have rested their decisions on the real purpose and objective of the participants.

In *Hellebush* v. *Commissioner,* 65 F. (2d) 902 (C. C. A. 6th), the stockholders had decided to quit business and liquidate their corporation. A purchaser was found for its properties and the stockholders by resolution authorized the dissolution and liquidation of the company and the conveyance of its assets to certain of its officers as trustees for the stockholders. On the same day the corporate officers transferred the property to the trustees, who then sold to the purchaser. The Board of Tax Appeals and the Circuit Court of Appeals held that this constituted a sale by the corporation itself, giving rise to taxable gain. The court said in part (p. 904):[3]

> The utmost that can be said for this resolution is that it constituted an agreement between the stockholders upon a procedure with which they were themselves contented and through which the Blackburn Company could sell its property. However satisfactory and unobjectionable this arrangement may have been as between themselves [*Chattanooga Savings Bank* v. *Brewer,* 9 F. (2d) 982, 989 (D. C.)], it could not impair the right of the Commissioner to challenge its validity for purposes of taxation. The law will look through forms to substance [*U. S.* v. *Phellis,* 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; *Board* v. *Comm'r,* 51 F. (2d) 73, 75 (C. C. A. 6)], and will recognize the out-

[3] While a specific regulation covered the situation in that case, the principle is the same here.

> standing fact, that the Cook Company had thereby acquired the property and assets of the Blackburn Company just as was contemplated before the stockholders' meeting on April 20th. We think that this was a sale by one company to the other upon the profits of which the Government was entitled to its taxes.

In *S. A. MacQueen Co.* v. *Commissioner,* 67 F. (2d) 857 (C. C. A. 3d), the three stockholders of a corporation, who were also its directors, adopted a resolution authorizing themselves to sell real estate owned by the corporation to its president, for the sum of $85,000. On the following day the president entered into an agreement with a purchaser to convey the real estate to the latter for $150,000, and executed a declaration of trust in which he recited his intention to distribute the profits proportionately to the stockholders. The transaction was carried out in this manner. In holding that the corporation was taxable on the sale price of $150,000, rather than $85,000, the court said (p. 858):

> The principle that substance and not form should control in the application of income tax laws [*United States* v. *Phellis,* 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; *Labrot* v. *Burnet,* 61 App. D. C., 47, 57 F. (2d) 413; *Reed* v. *United States* (C. C. A.) 51 F. (2d) 941] may be invoked in the instant case. Although in form there were two sales of the corporate real estate, first, the purported

sale by the petitioner to MacQueen, and, second, the sale by MacQueen to Hatfield, in substance the transaction was a sale by the petitioner to Hatfield through the agency of MacQueen. So also, although in form MacQueen was a trustee for the distribution of the profits earned by the sale of his own real estate to Hatfield, in substance he was the agent of the petitioner for the distribution of the profits from the sale of the corporation's real estate among its stockholders.

The corporate tax rate imposed by the applicable taxing statutes is higher than the individual rate. The obvious purpose of the procedure followed by the petitioner, its directors, and stockholders, was to take advantage of the lower tax rate permitted individuals and thereby avoid the corporate tax rate on the profits of the ultimate sale of the real estate. Such anticipatory arrangements and contracts, intended to circumvent the taxing statutes, are not looked upon with favor. *Lucas* v. *Earl,* 281 U. S. 111, 50 S. Ct. 241, 74 L. Ed. 731; *Phelps* v. *Commissioner* (C. C. A.) 54 F. (2d) 289, certiorari denied, 285 U. S. 558, 52 S. Ct. 458, 76 L. Ed. 946.

The petitioner argues that she did only what the Revenue Act permits. But the Revenue Act taxes such distributions in broad terms. It never was intended to permit avoidance of the tax by means of an agency created, it may be true, to conform to the literal specifications of a statute which had a certain end in view, but created with the sole purpose of avoiding the tax intended to be laid upon

all alike. Applying, as we submit the Court should, the principle that the real substance of the transaction should be the test, it must follow that the Monitor stock was distributed as a dividend to the petitioner from the Averill Corporation as a mere instrumentality and the value of the Monitor stock should be held to be taxable to the petitioner as a dividend.

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted.

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NOVEMBER, 1934.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived * * * from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(d) *Distributions by corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of

property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets

to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112 (g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between

such stock and the stock or securities distributed;

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earning or profits. * * *.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. * * *.

Treasury Regulations 74 (promulgated under the Revenue Act of 1928):

ART. 576. *Receipt of stock or securities in reorganization.*—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

ART. 578. *Source of distribution of stock or securities.*—The general rule, provided in section 115 (b), that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to a distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or of stock or securities in a corporation a party to the reorganization. Such a distribution will not be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, which are available for distribution and which under section 115 (b) must be distributed before earnings and profits accumulated before March 1, 1913, may be distributed exempt from tax.

* * * * *

ART. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

* * * * *

ART. 621. *Dividends.*—The term "dividends" for the purpose of Title I (except when used in sections 203 (a) (4) and 208 (c) (1)) comprises any distribution in the ordinary course of business, even though

extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913. * * *.

ART. 622. *Source of distribution.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 625. *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. * * *.

The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and article 561, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113 and articles 591–604; but the gain or loss will be recognized only to the extent provided in section 112 and articles 571–580. Any gain to the shareholder may, at his option, be taxed as a capital net gain in the manner and subject to the conditions prescribed in section 101 and articles 501–503. * * *

ART. 627. *Dividends paid in property.*—Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested, are income to the recipients to the amount of the market value of such property when receivable by the shareholders. (See, however, section 112 (h) and article 576.) Where a corporation declares a dividend

payable in stock of another corporation, setting aside the stock to be so distributed and notifying the shareholders of its action, the income arising to the recipients of such stock is its market value at the time the dividend becomes payable. * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1934

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY, *Petitioner,*

v.

GUY T. HELVERING, Commissioner of Internal Revenue

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

---

BRIEF AMICUS CURIAE

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EDWARD H. MCDERMOTT,
Amici Curiae.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 127

EVELYN F. GREGORY, *Petitioner*,

v.

GUY T. HELVERING, Commissioner of Internal Revenue

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

---

BRIEF AMICUS CURIAE

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 8-11) is *reported in* 27 B. T. A. 223 and of the Circuit Court of Appeals (R. 52-56) in 69 F. (2d) 809.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Second Circuit was entered March 26, 1934. (R. 38) Petition for certiorari was filed June 23, 1934, and was granted October 8, 1934. (R. 39) The jurisdiction of this

Court is invoked under section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (c. 229, §1, 43 Stat. 938), and section 1003 of the Revenue Act of 1926.

QUESTION PRESENTED

The exact question presented depends on the interpretation of the Circuit Court of Appeals' opinion and may be stated as follows:

(1) Is the term "reorganization", as defined in section 112(i)(1) of the Revenue Act of 1928, applicable to a transaction falling directly within the ordinary meaning of such definition but, in the opinion of the court below, not germane to ordinary business activities?

(2) Does a purpose to reduce income tax prevent a transaction which is otherwise within the words of the statute from being a "reorganization" as that term is defined in section 112(i)(1) of the Revenue Act of 1928?

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1928, c. 852, 45 Stat. 791, 818, provides:

"**SEC. 112. RECOGNITION OF GAIN OR LOSS.**

* * * * * * *

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) *The term 'reorganization' means* (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or *(B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,* or (C)

a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * * * *

"(j) *Definition of control.*—As used in this section the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." [Italics ours]

Other parts of the statute are set forth in the Appendix. (Exhibit "A")

STATEMENT

Evelyn F. Gregory, the petitioner, owned 5,000 shares being all the capital stock of the United Mortgage Corporation. She had purchased 3,300 shares in 1920 and 1921 for $180,000 and the remaining 1,700 shares in 1927 and 1928 for $170,000, her total cost thus being $350,000. (R. 13)

United Mortgage Corporation owned 1,000 shares of the capital stock of Monitor Securities Corporation, which had cost $10,413.07 in 1922 and was salable in 1928 at a profit. (R. 18, 22, 24) To reduce income taxes on the sale of the Monitor shares, especially the double tax which would result from a sale by the United company followed by a distribution of the proceeds to petitioner (R. 18), the following steps were taken:

On September 18, 1928, Averill Corporation was organized under the laws of Delaware. On September 21, 1928, United Mortgage Corporation transferred the 1,000 shares of Monitor stock to Averill Corporation, the latter in exchange issuing all of its own stock directly to the petitioner. On September 24, 1928, Averill Corporation was liquidated, petitioner receiving in such liquidation the 1,000 shares of Monitor stock. Petitioner thereupon sold the Monitor stock for $133,333.33. (R. 19)

In her tax return, petitioner treated the transfer of the 1,000 shares of Monitor stock by United Mortgage Corpora-

tion to Averill Corporation for its stock as a reorganization within section 112(i)(1) of the Revenue Act of 1928; the receipt by her of the Averill stock as a non-taxable distribution in reorganization under section 112(g); and the receipt by her of the 1,000 shares of Monitor stock upon liquidation of Averill Corporation as a distribution in liquidation taxable under section 115(c). She computed her gain on this liquidating distribution as follows:

The Monitor stock was valued at $133,333.33, being the sale price. From this she subtracted the sum of $57,325.45, thereby showing a profit on the liquidation of $76,007.88 taxable as capital net gain. She arrived at the cost figure of $57,325.45 (under section 113(a)(9) of the Revenue Act of 1928) by allocating to the Averill shares a proportion of the $350,000 original cost of the United Mortgage Corporation stock, computed by comparing the fair market value of the Averill shares when received by her with the fair market value of the United Mortgage Corporation shares on the same day. (R. 14, 22, 23)

Having reported a taxable profit of $76,007.88 upon receipt of the 1,000 shares of Monitor stock in liquidation of Averill Corporation, she reported no further gain upon the sale of the Monitor shares.

The Commissioner of Internal Revenue treated the transaction as an ordinary dividend of the Monitor stock to petitioner by United Mortgage Corporation, in the amount of $133,333.33. (R. 20)

The Board of Tax Appeals rejected the Commissioner's contention and, with an exception not here material, upheld the treatment shown in the taxpayer's return. (R. 8-11)

The Circuit Court of Appeals held that there was no reorganization under section 112(i)(1) and that the receipt of the Averill shares by petitioner was not a distribution in reorganization under section 112(g) but should be taxed to petitioner as an ordinary dividend in the amount of $133,333.33. (R. 52-56)

SUMMARY OF ARGUMENT

Believing that the decision below strikes at long-established doctrines of tax law; that it misconceives and largely frustrates the intent of Congress; that the proposed subjective tests of liability are defective and impracticable of application to concrete cases; that by substituting doubt for reasonable certainty it invites a flood of unnecessary tax litigation to the detriment alike of taxpayers and the Treasury; and that it tends completely to destroy a carefully laid legislative plan for the taxation of important transactions, counsel *amici curiae*, with the consent of the parties, respectfully submit this brief and request reversal of the decision of the Circuit Court of Appeals for the Seventh Circuit.

ARGUMENT

I

The term "reorganization" in section 112(g) should be construed according to the plain meaning of the definition in section 112(i)(1).

It is not disputed that, *if* the acquisition by Averill Corporation, under the circumstances in this case, of the Monitor shares being part of the property of United Mortgage Corporation (petitioner obtaining control of Averill Corporation) is a reorganization within the statute, the decision of the Board of Tax Appeals is correct and that of the Cirsuit Court of Appeals is wrong. The sole question is whether there was a "reorganization", as defined in section 112(i)(1).

The opinion of the Circuit Court of Appeals may be construed as holding that, although a purpose to reduce taxes does not control, the term "reorganization" is inapplicable to transactions not germane to the ordinary business activities of the participants even though falling directly within the definition, which is as follows:

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) The term 'reorganization' means * * * (B) a transfer by a corporation [United Mortgage Corporation] of all or a part of its assets [1,000 shares of Monitor stock] to another corporation [Averill Corporation] if immediately after the transfer the transferor or its stockholders [petitioner] or both are in control of the corporation to which the assets are transferred, * * *" [Revenue Act of 1928, Sec. 112]

"Control" is defined in section 112(j) as 80 per cent or more of the stock of a corporation.

The court below has interpreted the definition as though it concluded with this phrase:

"* * * *except* cases where such transfer is not germane to the particular trade or business"

It has long been settled that the words of an Act, if plain, control its application. In *United States v. Shreveport Grain & Elevator Company*, 287 U. S. 77, 83, this Court said, quoting from *United States v. Hartwell*, 6 Wall. 385, 396—

"If the language be clear it is conclusive. There can be no construction where there is nothing to construe."

To like effect, see *Texas & Pacific R. Co. v. United States*, 289 U. S. 627, 636, 638; *United States v. Standard Brewery, Inc.*, 251 U. S. 210; *Adams Express Company v. Kentucky*, 238 U. S. 190, 199. Construction presupposes ambiguity. (*Hamilton v. Rathbone*, 175 U. S. 414, 421) Though the intention of Congress is the object sought, the words of the Act, if plain, are "its only expositors". (*Pirie v. Chicago Title & Trust Co.*, 182 U. S. 438, 450; *United States v. Goldenberg*, 168 U. S. 95, 102)

These long-established doctrines apply "with peculiar strictness" to tax statutes. (*Old Colony R. Co. v. Commis-*

sioner, 284 U. S. 552, 560; *Crooks v. Harrelson*, 282 U. S. 55, 61) In the latter case, the Court said—

> "Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter *applies with peculiar strictness*. In *United States v. Merriam*, 263 U. S. 179, 187, 188, after saying that 'In statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used,' we quoted with approval the words of Lord Cairns in *Partington v. Atty. Gen.*, L. R. 4 H. L. 100, 122, that 'if the Crown, seeking to recover the tax, can not bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'" [Italics ours]

Where, as in the present case, the Court is dealing with a highly *specific* portion of a tax statute the force of the literal language is even greater, as was recognized below both by the Board of Tax Appeals (*Gregory*, 27 B. T. A. 223, 225) and the Circuit Court of Appeals (*Helvering v. Gregory*, 69 F. (2d) 809, 810 (C. C. A. 2nd).

There are the strongest of reasons for holding that a *statutory definition* means precisely what it says. It is a warning to discard ordinary meanings and shows close legislative attention to the new meaning. In *Porter v. Commissioner*, 288 U. S. 436, 441, the Court considered the meaning of "net estate". The term was expressly defined in the statute. The Court held that other meanings were necessarily excluded.

Merritt v. Welsh, 104 U. S. 694, 702;
Selden v. Equitable Trust Co., 94 U. S. 419;
Warren v. Shook, 91 U. S. 704;

Slack v. Tucker, 23 Wall. 321;
Schweizer v. Mager, 297 Fed. 334 (D. C. N. D. Ill.);
Cothran v. United States, 276 Fed. 48 (D. C. W. D. Va.);
Candado Stevedoring Corp. v. Locke, 1 F. Supp. 456 (D. C. E. D. N. Y.).

This Court has been asked, not infrequently, to discard the plain language of revenue statutes but, so far as we can find, has uniformly declined to do so. One such case was *Crooks v. Harrelson*, 282 U. S. 55, 59, which involved a construction of the estate tax statute (Sec. 402, Revenue Act of 1918). The Court said—

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose of the act in order to give effect to the intent of Congress. The principle sought to be applied is that followed by this Court in *Church of the Holy Trinity v. United States*, 143 U. S. 457; but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. Compare *Pirie v. Chicago Title & T. Co.*, 182 U. S. 438, 451, 452. And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail. *Treat v. White*, 181 U. S. 264, 268."

Others are *Lang v. Commissioner*, 289 U. S. 109, 113; *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560; *Treat v. White*, 181 U. S. 264, 267; *United States v. Goldenberg*, 168 U. S. 95, 102, 103.

Helvering v. New York Trust Co., 292 U. S. 455, *Pinellas Ice & Cold Storage Company v. Commissioner*, 287 U. S.

462, and like cases, fall far short of authorizing the contradiction below. In the *New York Trust Company* case, a corporate trustee sold stock which it had received about a year previously from its customer, the trustor. The question was whether the stock had been "held * * * for more than two years" within section 206(a)(6) of the Revenue Act of 1921 so that the profit could be taxed at capital gain rates. The trustor had owned the stock for many years. The transfer to the trustee did not represent any disposition to outside interests. It was a mere step in an uncompleted gift to the trustor's son. The gift was to be completed when the son reached a certain age. The trustee contended that the two-year period should be computed by adding the tenure of the trustor. A later Revenue Act authorized tacking in such cases. The great object of Congress, admitted by all, was to afford relief to sellers of capital assets. Admittedly, the stock was such an asset unless it be held that the corporate trustee was so far removed from its customer, the trustor, as to require the stock to be classed as freshly-acquired property. Under the Revenue Act a trustee, though not a legal entity for all purposes, had some of the characteristics of a "taxpayer". Having regard to these facts and to the intent of Congress, a majority of the Court found a latent ambiguity in the phrase "held * * * for more than two years" and decided that the trustee was entitled to the benefit of the capital gains provisions.

A latent ambiguity by which an out-and-out *sale for cash* (payments deferred 120 days) might be taxed as a reorganization, may have been the condition precedent to construction in *Pinellas Ice and Cold Storage Company v. Commissioner*, 287 U. S. 462. There is a full discussion of the *Pinellas* case under a separate head of this brief.

In the present case, on the contrary, the words of the definition are clear. The court below does not suggest

ambiguity. The Board found none. We submit there is none. Neither of the cases mentioned control this case.

If it is relevant here, in the absence of ambiguity, to examine the settled administrative construction, it will be found that, until recently, the term "reorganization" has been applied according to the literal meaning of the definition. The administrative construction goes back to the Revenue Act of 1921 (Sec. 202(c)(2)) where the definition first appeared in its present form, exclusive of an important phrase added in 1924 which will later be mentioned, and is shown in the official Regulations, the published rulings of the Commissioner of Internal Revenue, and the reported decisions of the Board of Tax Appeals.

Regulations 74, issued under the Revenue Act of 1928, provides:

> "**Art. 574. Exchanges in connection with corporate reorganizations.**
>
> * * * * * * *
>
> If two or more corporations reorganize, for example, by—
>
> * * * * * * *
>
> "(4) *The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X corporation or its shareholders or both are in control of the Y Corporation*—
>
> then no taxable income is received from the transaction by the X Corporation * * * if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of * * * the X Corporation * * * if the sole consideration received by the shareholders is stock or securities of the Y Corporation.
>
> "If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Cor-

poration and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.)" [Italics ours]

Let X designate United Mortgage Corporation and Y the Averill Corporation and the present transaction is squarely within the Regulations.

See also Article 577 of the same Regulations.

There were similar provisions in the Regulations under the Revenue Acts of 1926 and 1924, the latter being the Act where the statutory definition of "reorganization" first assumed the same form as in the Revenue Act of 1928. (See Regs. 69 and 65, Arts. 1574 and 1577)

The literal application of the definition by the Commissioner of Internal Revenue and by the Board of Tax Appeals in particular cases is shown by:

Published Rulings:

I. T. 2530, IX-1 C. B. 194;
G. C. M. 7285, IX-1 C. B. 181;
G. C. M. 3827, VII-2 C. B. 114;
G. C. M. 2579, VII-1 C. B. 198.

Decisions of Board of Tax Appeals:

Stires Corp., 28 B. T. A. 1;
Holmby Corp., 28 B. T. A. 1092;
Green, 24 B. T. A. 719;
National Pipe & Foundry Co., 19 B. T. A. 242, 250;
First Nat. Bank of Champlain, 21 B. T. A. 415;
Tulsa Oxygen Co., 18 B. T. A. 1283.

Since 1924, and in the light of this uniform administrative construction, Congress has successively reenacted (and enlarged) the definition of "reorganization". (Sec. 203 (h)(1), Revenue Act of 1924; Sec. 203(h)(1), Revenue Act of 1926; Sec. 112(i)(1), Revenue Act of 1928) The 1928 Act is the statute before this Court. These repeated reenactments show Congressional adoption of the administrative construction of the definition according to the literal meaning of the words.

Massachusetts Mutual Life Insurance Co. v. United States, 288 U. S. 269;
Old Colony R. Co. v. Commissioner, 284 U. S. 552;
Poe v. Seaborn, 282 U. S. 101;
Wisconsin v. Illinois, 278 U. S. 367, 413;
United States v. Hermanos, 209 U. S. 337;
United States v. Falk, 204 U. S. 143.

If we examine the circumstances of the enactment and its antecedent history (*Karnuth v. United States,* 279 U. S. 231, 243; *United States v. Katz,* 271 U. S. 354, 357; *American Tobacco Co. v. Werckmeister,* 207 U. S. 284, 293) the conclusion that the definition should be taken to mean what it says is still further confirmed.

Throughout the Commissioner's argument runs the assumption that Congress, in laying down the definition of "reorganization", was not well informed on the subject. He believes the legislature was grappling with a new and elusive problem, the details and concrete solutions of which, at the time, were obscure and largely unrecognized. Under the circumstances, Congress is assumed to have been unable to state its plan in precise detail. It could legislate, argues the Commissioner, only in terms of broad policy, leaving to the courts the working out of concrete solutions in particular cases. The conclusion is drawn that the literal words of the definition may well fail to express the real intent in a particular case—for example, in this case.

That result might well follow if the Commissioner's assumptions were correct. But they are not correct. The circumstances and history of the definition of "reorganization" are discussed in detail under Point III of this brief but may profitably be outlined here.

So-called "reorganization" tax problems are neither recent nor unique. They were active as early as the Revenue Act of 1909. (*United States v. Alpha Portland Cement Co.,* 257 Fed. 432 (D. C. E. D. Pa.), reversed 261 Fed. 339 (C. C. A. 3rd)) Two of the five principal "reorganization"

cases in this Court arose under the Revenue Act of 1913. (*Rockefeller v. United States,* 257 U. S. 176; *United States v. Phellis,* 257 U. S. 156) The three remaining cases involved the Revenue Act of 1916. (*Marr v. United States,* 268 U. S. 536; *Weiss v. Stearn,* 265 U. S. 242; *Cullinan v. Walker,* 262 U. S. 134) The tax treatment of "reorganization" has had a great many years of study and analysis.

By 1921, the Treasury had enjoyed the benefit of twelve years of active experience with these problems. It had dealt with thousands of concrete cases. Dozens of rulings and opinions had already been published. Some are collected in Exhibit "B" attached. The unpublished rulings were much more numerous. The Treasury had a vast fund of experience, data, and solutions in particular cases. For years it was, and still is, the great clearing house of information on every aspect of "reorganization" and the sole possessor of accurate concrete knowledge of *all phases of the problem.* It was well prepared to announce its conclusions in 1921.

In the light of this experience, *the Treasury experts prepared the original draft of the Revenue Act of 1921. This is the rich background of the definition of "reorganization".* Dr. Thomas S. Adams and the other Treasury experts sat with Congress and its fiscal committees throughout the entire course of the legislation. They counseled with the legislators daily. Each provision was a "bloody battle ground" gone over inch by inch by the Committees and by the Houses of Congress. Each clause was intensively considered and studied. Concrete amendments were proposed, debated, and accepted or rejected. The original definition prepared by the Treasury experts was reshaped to fit into the crystallized detailed Congressional plan. (See Exhibit "C" attached) The refined product was duly enacted.

It is instructive to note, as showing the careful discrimination in the tax statute, that "reorganization" was em-

ployed in the profits tax statutes of 1918 and 1921, with an entirely different meaning. (Revenue Acts of 1918 and 1921, Sec. 331)

The same legislative procedure was repeated in 1924, but with the benefit of three more years of experience. Further study by the Treasury experts and further legislative consideration resulted in certain modifications, mainly by way of *enlargement* of the statutory concept of "reorganization". The definition reached maturity in the Revenue Act of 1924. It was reenacted without change in the Revenue Acts of 1926 and 1928. It is very plain that the definition was not at all an attempt to express a merely general policy. *It was a specific definition developed from concrete cases.* And Congress was indeed well informed.

Much of the argument to disregard the definition is based, we believe, on a failure to understand the function the term "reorganization" performs in the statute. By itself "reorganization" is meaningless. Standing alone, it determines neither the taxability of a gain (G. C. M. 3110, VII-1 C. B. 51), the deductibility of a loss, nor any other tax problem. Gain or loss depends upon particular subsections of section 112. (See Sec. 112 (b)(3), (b)(4), (c), (d), and (e)) Questions of basis are determined by section 113. (See Sec. 113(a)(6) and (a)(9) and Sec. 114(a)) Distribution problems are determined under sections 112, 113, and 115. (See Sec. 112(d)(1), (d)(2), (g), and (h), Sec. 113(a)(9), and Sec. 115(c)) Questions of capital gains or losses are determined by section 101. (See Sec. 101(c)(8)(A), (B), and (C)) The definition is merely a convenient description to which reference is made in other parts of the Act dealing specifically with the various classes of problems involved. The same yardstick—the definition of "reorganization"—applies to all of these problems. A narrow construction in a gain case means a broad construction in a loss case or in a case involving basis, certain types of distribution, or capi-

tal losses. It is indeed a superficial view of the statutory scheme to restrict the definition so as to tax a particular gain when by so doing exactly the opposite effect is produced in a loss case, a basis case, or some other kind of a case.

When it is recognized that the definition is simply a unit of measurement—a carefully calculated yardstick—applicable alike to numerous classes of cases, sometimes invoked to the benefit of the Treasury and sometimes by the taxpayer, the error of another argument becomes apparent. The Commissioner refers to the reorganization provisions as "exemptions" or as providing "exceptional treatment"; hence requiring strict construction. But, as we have seen, a narrow construction favors the Treasury in one case, and the taxpayer in others. In effect, as it seems to us, the Commissioner says that the yardstick ought to be 35 or 37 inches, whichever produces the greater tax. Justice can not be produced by distorting the unit of measurement. The net results are mixed and wholly beyond prediction.

There is a more fundamental objection. Even in a gain case like the present, no "exemption" is involved. The "reorganization" provisions simply authorize complete or partial *deferment* of present taxation. This deferment, let it be noted, is conditioned upon *an extra burden of future tax.* In the present case, for example, when Mrs. Gregory sells her *United* stock she will pay tax on the $57,325.45 portion of the proceeds, taxation of which is presently deferred. (Revenue Act of 1928, Secs. 111(a) and 113(a)(9)) Comparing the low tax rates in 1928 with the high rates at the present time and in prospect for the future, it is quite possible that the Government will receive more, rather than less, taxes from her because of the reorganization provisions. To characterize these nicely-calculated self-compensating *deferment* provisions as "exemptions" or "favored treatment" and for that reason subject to a narrow construction is utterly to misunderstand the statute.

Based upon an examination of the statute and a few of the principal circumstances attending its passage, the following appears:

First: In the absence of ambiguity—and there is none here—the settled rules of construction, applicable with "peculiar force" to tax cases, call for a literal application of the definition.

Second: The unusually specific terms of the definition must be read as a legislative command to follow its clear language.

Third: The Court is construing a *definition.* Congress proposed to exclude all other meanings. Powerful reasons stand in the way of amendments or substitutions under the cloak of construction.

Fourth: The definition came from the Treasury. As the product of a decade of experience and of intensive consideration and shaping by well-informed legislators, the studiously composed language fully deserves to be the sole measure of its own scope and application.

Fifth: The definition is a yardstick which, by itself, does not determine tax liability. By virtue of other parts of the Act, however, it affects many types of cases. In a gain case a narrow construction of "reorganization" favors the Treasury, *but in a loss or basis case it favors the taxpayer.* The same definition can not be narrow in one case and broad in another. Considerations of "equity", if such exist in tax matters, should certainly not be resolved by changing the unit of measurement. Its great value lies in its unvarying dependability. The plain meaning of plain words is the best guide to that end.

Sixth: "Reorganization" is at the root of a well considered Congressional scheme for tax *deferment* in selected types of cases. The Court is not dealing with "exemption" or "special treatment". It is misleading to urge a narrow construction upon that ground. With increasing frequency these days the reorganization sections mean more tax rather

than less. The self-compensating provisions which insure the orderly functioning of the selective deferments, require that the integrity of the unit of measurement be maintained. The yardstick should be taken at its face value.

II

A purpose to reduce taxes is immaterial, provided the transaction otherwise falls within the statutory definition of "reorganization".

Despite certain passages in the opinion, the decision below has generally been interpreted as holding that a purpose to reduce or avoid taxes may render the statute inapplicable to a transaction even though plainly within its terms.

Since *United States v. Isham,* 17 Wall. 496 (1873), it has been settled doctrine that a purpose to reduce or avoid taxation is immaterial to tax liability. As this Court said in *Superior Oil Co. v. Mississippi,* 280 U. S. 390, 395–396, involving a transaction the sole purpose of which was to escape taxation—

> "The fact that it desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you intentionally may go as close to it as you can, if you do not pass it. *Bullen v. Wisconsin,* 240 U. S. 625, 630, 631."

To like effect, see *United States v. Phellis,* 257 U. S. 156, 172; *Bullen v. Wisconsin,* 240 U. S. 625. Among numerous decisions in the courts below, see—

Wiggin v. Commissioner, 46 F. (2d) 743 (C. C. A. 1st);
Brunton v. Commissioner, 42 F. (2d) 81 (C. C. A. 9th);
Iowa Bridge Co. v. Commissioner, 39 F. (2d) 777 (C. C. A. 8th);
Bing v. Bowers, 22 F. (2d) 450 (D. C. S. D. N. Y.);

Fraser v. Nauts, 8 F. (2d) 106 (D. C. N. D. Ohio);
Weeks v. Sibley, 269 Fed. 155 (D. C. N. D. Texas).

The same rule is found in the decisions of the Board of Tax Appeals:

Fruit Belt Telephone Co., 22 B. T. A. 440, 441, 442;
Houston Bros. Co., 21 B. T. A. 804, 813;
Brackett, 19 B. T. A. 1154, 1159, 1160;
Harkness, 1 B. T. A. 127;

and the rulings of the Commissioner of Internal Revenue:

S. O. 149, II-1 C. B. 20, 23;
L. O. 1062, 4 C. B. 168, 171.

As this Court said in *United States v. Phellis*, 257 U. S. 156, 172, a reorganization case arising under an early Revenue Act, "In such matters, what was done, rather than the design and purpose of the participants, should be the test". (*Remington Rand, Inc. v. Commissioner*, 33 F. (2d) 77 (C. C. A. 2nd), cert. den. 280 U. S. 591; *Harkness*, 1 B. T. A. 127; *Brackett*, 19 B. T. A. 1154, 1159, 1160)

By successive reenactments this salutary doctrine has become part and parcel of the statute.

Massachusetts Mutual Life Insurance Company v. United States, 288 U. S. 269;
Old Colony R. Co. v. Commissioner, 284 U. S. 552;
Poe v. Seaborn, 282 U. S. 101;
Wisconsin v. Illinois, 278 U. S. 367, 413.

If tests of tax liability are to become subjective instead of objective, if intent is to be raised to a position of controlling importance, the highly essential factor of certainty which mainly makes administration of the law possible disappears. Courts are familiar with the manifold difficulties of proving intent.

Moreover, there is no stopping place between the doctrine of the foregoing cases—that intent is immaterial—and the

novel concept that each taxpayer owes a duty so to fit his transactions into the Revenue Act as to produce the *greatest* amount of tax. Standards of liability based on an "average" transaction, a "fairly conducted" transaction, or a "strictly business" transaction, are imaginary to the point of hopeless impracticability.

Under the decision below, is tax avoidance involved in the purchase of tax-exempt Government bonds? What if a profitable sale is rejected because of the tax burden? If property is sold at a loss to offset other income? Should a trustee, guardian, or director heed the command of the State law to conserve the property in his custody or that of the Federal law if it requires him to pay a maximum tax?

We can not believe the Commissioner proposes seriously to argue that the Court abandon its traditional doctrine. If he does, the above decisions, and the reasons on which they are based, afford a complete answer.

III

The decision below defeats the intent of Congress.

In the first place, the law is clear that intent is primarily to be sought in the statute itself.

> *Thompson v. United States,* 246 U. S. 547, 551;
> *Pirie v. Chicago Title & Trust Co.,* 182 U. S. 438, 450;
> *Treat v. White,* 181 U. S. 264, 267;
> *Merritt v. Welsh,* 104 U. S. 694, 702.

There is nothing in the Act to support the finding of the Circuit Court of Appeals that Congress intended anything to depend on whether a given transaction was "germane". The court, we think, has fallen into the error of substituting conjecture for plain language.

If the purposes of Congress are sought in extraneous sources (*United States v. Dubilier Condenser Corp.,* 289 U. S. 178, 205, 206, 218, 220, 222; *United States v. Mo. Pac.*

R. Co., 278 U. S. 269, 279; *United States v. St. P. M. & M. Ry. Co.*, 247 U. S. 310, 318, 319; *Binns v. United States*, 194 U. S. 486, 495) positive evidence will be found that Congress meant what it said in the statutory definition of "reorganization". Congress proposed to *include* non-germane transactions.

(a) *Nature of "reorganization" problems.*—It is probably unfortunate that Congress selected the word "reorganization" instead of "readjustment" or some other term having no fixed meaning in the law. Despite the defined meaning of "reorganization", there is a disposition to associate the tax concept with other concepts of "reorganization". As employed in the tax statute, the term is much broader than in other fields. A correct understanding may be promoted by considering briefly the nature and scope of the problem in tax cases.

The American concept of income, unlike the English (S. Rept. 275, 67th Cong., 1st Sess., p. 13), includes the recognition of gains and losses from the sale or other disposition of capital assets.

> *Merchants' Loan & Trust Co. v. Smietanka*, 255 U. S. 509;
> *Hays v. Gauley Mountain Coal Co.*, 247 U. S. 189.

Where the asset is *sold* the problem of taxation is not especially difficult. Where the asset is *exchanged*, the computation of gain or loss uniformly requires the valuation of the asset received. In many instances valuation is difficult; in some, practically impossible. Valuation has been a very troublesome problem to the Bureau of Internal Revenue. (*Hearings on H. R. 8245 (Revenue Act of 1921) before Senate Finance Committee*, 67th Cong., 1st Sess., Sept. 1-Oct. 1, 1921, pp. 27-28, referred to hereafter as *"Senate Hearings, 1921 Act"*)

Further complications arise upon exchanges, frequently of stock or securities, which do not involve final disposi-

tions to outside interests. In these cases, the property received is not essentially different from the property disposed of. Technically, gain or loss has been realized, but this is only true in a very formal sense. These sorts of exchange are found frequently in "reorganizations". How should they be taxed?

The general scope of "reorganization" problems from a tax standpoint may be outlined by starting with the simple case of an individual who incorporates his business. He exchanges property (assets of the sole proprietorship) for stock of a new corporation. A partnership may be incorporated. A corporation may turn over all or part of its assets to another corporation for stock which is retained by the transferor or distributed to its stockholders. Several corporations merge, consolidate, or transfer part of their properties to one or more new corporations for stock which is retained by them or distributed to their stockholders. Instead of acquiring property, the new corporation may acquire all or part of the stock of one or more old corporations in exchange for its own stock, thereby creating the relation of parent and subsidiaries. A corporation reincorporates or makes other changes in its capital structure involving exchanges of securities.

Particular illustrations of typical "reorganization" problems will be found in *Marr v. United States,* 268 U. S. 536; *Weiss v. Stearn,* 265 U. S. 242; *Cullinan v. Walker,* 262 U. S. 134; *Rockefeller v. United States,* 257 U. S. 176; *United States v. Phellis,* 257 U. S. 156; published rulings of the Bureau of Internal Revenue attached as Exhibit "B", and Articles 572-580, 591, 597-601, 625, 628, and 629 of Regulations 74 (issued under the Revenue Act of 1928).

In many of these cases there has been, at most, a formal exchange; gain or loss has only technically been realized. Property has been received, but the tax must be paid in cash.

(b) *Congress was well informed on the subject.*—The

problems of gain, loss, and basis involved in the tax treatment of "reorganization" exchanges are not of recent origin. As stated under a previous branch of the Argument, they go back at least to the Revenue Act of 1909. The Treasury had a decade of experience with "reorganization" prior to the first legislation on the subject in the Revenue Act of 1918 (Sec. 202(c)(2)). Under the prior Acts, gain and loss were fully recognized, formal exchanges being treated the same as all other exchanges. The fact of subsequent legislation shows that this treatment was considered unsatisfactory.

Section 202(c)(2) of the Revenue Act of 1918 covered but a small portion of the field. Nevertheless, it furnished a beginning. The Treasury had numerous cases involving all aspects of the reorganization problem presented to it in the returns under the great War Revenue Acts of 1917 and 1918. (See Exhibit "B") The problems, one by one, were subjected to analysis and appropriate solutions were worked out by Treasury experts. The Treasury was the great clearing house of information on "reorganization". Within the Treasury the problem could be viewed in its entirety. This was a unique advantage which the courts do not enjoy.

The Treasury was convinced that treatment by judicial or administrative methods, unaided by legislation, was inadequate. The courts had not gotten beyond the cases under the 1913 and 1916 Acts. As late as 1921, the only final decisions on "reorganization" were *Rockefeller v. United States,* 257 U. S. 176, and *United States v. Phellis,* 257 U. S. 156, both decided two days before the 1921 Act was signed and both dealing with the 1913 law.

Administrative treatment by rules or regulations was discarded, in large part because of uncertainty as to their legal status.

Congress early settled upon the policy of placing in the statute itself such of the policies and solutions worked out by the Treasury Department as were approved by the

legislators. Dr. Adams, an able advisor of the Treasury Department, stated on September 1, 1921, to the Committee on Finance of the Senate (*Senate Hearings, 1921 Act,* p. 24)—

> "DR. ADAMS. We should have a statutory rule. The old rule was simpler than the one proposed, but in view of the decisions referred to we feel that the proposed rule is the right one, and perhaps the only safe one. We should take no chances with a rule which the courts might upset.
>
> "THE CHAIRMAN. Has it not been the policy to bring these things within the law, so that they will be fixed and settled?
>
> "DR. ADAMS. Yes."

Treasury policy developed rapidly. In 1921, the Treasury was prepared to submit its views to Congress. *The Treasury prepared the first draft of the Revenue Act of 1921,* a fact of prime importance in this case. (*Hearings on Internal-Revenue Revision before House Committee on Ways and Means,* 67th Cong., 1st Sess., July 26-29, 1921, p. 406; *Senate Hearings, 1921 Act,* p. 4)

Moreover, Dr. Adams and other Treasury experts collaborated "with the House Committee * * * throughout their entire work on the bill". (*Senate Hearings, 1921 Act,* p. 4) J. S. McCoy, Treasury Actuary, and John E. Walker, Chief, Legislative Drafting Service, United States Senate, were also in attendance upon the Committee on Finance of the Senate. (*Senate Hearings, 1921 Act,* p. 3)

It was the settled policy of these Committees to examine all the details of the revenue bills referred to them. The Chairman of the Committee on Finance of the Senate said (*Senate Hearings, 1921 Act,* p. 21)—

> "THE CHAIRMAN. Those who were very active in the last bill know that pretty nearly every one of these paragraphs is a bloody battle ground. We fought every inch of it.
>
> "DR. ADAMS. This one will be particularly—

"SENATOR LA FOLLETTE. Gory?

"DR. ADAMS. I do not know whether it will be gory or not."

That Congress was well informed and acted advisedly in formulating its precise and detailed policy for the tax treatment of reorganization exchanges and related problems can not be seriously questioned.

(c) *A major purpose, wholly defeated by the decision below, was to disallow non-germane losses.*—Some of the purposes of the Treasury in connection with "reorganization", adopted by Congress, were stated by Dr. Adams, the Treasury Advisor, as follows (*Senate Hearings, 1921 Act,* p. 29):

> "DR. ADAMS. The change is recommended because, in the first place, it is difficult to make appraisals. In the average reorganization, or in many reorganizations, there is no definite, fixed market price for the securities. That is one reason. In the second place, it is possible to avoid the tax by the use of no par-value stock. In the third place—and this is the most important reason—where any heavy tax is involved the reorganization is held up. They do not do it. All kinds of business readjustments have been stopped. *Finally this process is now being indulged in to register losses.* When they could make heavy gains, which would subject them to a heavy tax, the transaction is blocked. *On the other hand, where losses are to be registered, there is an additional incentive to make the reorganization.* But the principal defect of the present law is in blocking desirable business readjustments." [Italics ours]

To the same effect, see the report of the Committee on Ways and Means (H. Rept. 350, 67th Cong. 1st Sess., p. 10) and the report of the Committee on Finance (S. Rept. 275, 67th Cong., 1st Sess., p. 11). The pertinent portion of the latter report is quoted in Exhibit "C".

The decision below utterly defeats the purpose to wipe out colorable losses in fictitious exchanges. The facts

of the present case need be changed but slightly to illustrate the point. Assume the assets of United Mortgage Corporation had depreciated so that by 1928 the stock which cost petitioner $350,000 was worth but $100,000. Suppose petitioner desired to "register" the loss, without, however, finally disposing of the United stock. Assume she organized Averill Corporation and caused all the United assets to be transferred to it, she exchanging her United stock for Averill stock. The transaction would be even less "germane" to business activities than the transaction as it actually occurred in this case. For obvious reasons, loss transactions are notoriously *non*-germane. If the definition of "reorganization" is literally applied, petitioner's loss would be disallowed under section 112(b)(3) and full effect would be given to the intent of Congress. But if the definition is subject to the "germane" restrictions read into it by the court below, *the non-germane loss would be allowable* under section 111(d) and a primary purpose of Congress *defeated.*

This, then, is the effect of the decision below: *It opens the door wide to the allowance of non-germane losses and thereby defeats the intent of Congress that such losses be denied.* Congress had to defer non-germane gains in order to block non-germane losses (the illustrative case). It was perfectly willing to do this and said so in plain words. As this Court pointed out in *Van Camp & Sons Company v. American Can Co.*, 278 U. S. 245, 253, to depart from plain language is to invite the danger of "relieving from the grasp of the statute some [cases] * * * the legislature definitely meant to include". That is the effect of the decision below.

(d) *The intent of Congress to promote certainty is defeated.*—The intent to provide certainty and definiteness is so obvious from the reports of the House Ways and Means Committee (H. Rept. 350, 67th Cong., 1st Sess.) and the Senate Finance Committee (S. Rept. 275, 67th Cong.,

1st Sess.) on the 1921 Act as to require no argument. See, in addition, the report of the Committee on Finance on the 1924 Act, S. Rept. 398, 68th Cong., 1st Sess. Litigation thrives on uncertainty and Congress wished to diminish tax litigation. See report of the Committee on Finance on the 1928 Act, S. Rept. 960, 70th Cong., 1st Sess., pp. 16-17.

The injection of unexpressed qualifications into the clear language of the statute shakes confidence in the integrity of the definition and in the Act generally. That which was certain becomes conjectural. Every important tax return becomes a potential law suit. Neither the income tax officers nor the courts could cope with such a flood of litigation. Over-zealous administrators are invited to visit liabilities upon transactions squarely within the Act. Business can not proceed on such a basis and Congress did not intend that it should be compelled to do so.

It is pertinent to inquire whether all of the 50 or more definitions in the Act possess powers of expansion and contraction such as those attributed below to "reorganization". Also, if words can be modified to impose a tax, can not they also be modified to escape tax—and thus produce the avoidances the court below desired to stop? Can fraud penalties or indictments be successfully maintained where the clear words of a tax statute fail to disclose its true meaning? These are but a few of the consequences of uncertainty. Congress wished to avoid all of them.

(e) *The purpose to avoid unnecessary valuations is defeated.*—It will be recalled that the administrative difficulty of valuation was an important reason for the adoption of the reorganization provisions. If the scope of the definition is narrowed by construction, the necessity of valuations is correspondingly increased and this is true in loss cases as well as gain cases. The purpose to avoid unnecessary valuations can be accomplished by giving full effect to the words of the definition. It is defeated, in substantial part, by the decision below.

(f) *The 1924 Act indicates that Congress intended to include the present case.*—The general definition, as we have seen, goes back to the 1921 Act. But the particular clause which covers the present case was added in the 1924 Act, and is as follows:

> "(1) *The term 'reorganization' means*
>
> * * * * * * * *
>
> *(B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,* * * * "[Revenue Act of 1924, Sec. 203(h)(1)—Italics ours]

In 1924, as in 1921, the Treasury prepared the first draft of the Act. Its Revision Board had devoted the entire summer to the bill. The experts worked constantly with the Committees of Congress. (*Hearings on Revenue Revision, 1924, before House Ways and Means Committee,* 68th Cong., 1st Sess., Jan. 14-19, 1924, pp. 112-114, 175-179, 456-457, 469-470)

The specific clause of the definition which covers the present case thus originated with the Treasury Department. Moreover, the unqualified addition of the clause to the definition in 1924 shows that legislative attention was specifically called to the kind of a transaction now before the Court and that Congress decided it should be *included.* The absence of any words restricting the new clause to transactions germane to business strongly indicates that Congress intended no such limitation.

(g) *Congress considered that the prescribed adjustments to basis in section 113 constituted sufficient safeguards.*—The reorganization *definition,* as we have seen, has no effect in itself on gain, loss, basis, or any other question. Detailed subsections elsewhere throughout the Act provide the solutions to these problems.

A careful study of the various subsections of section 112 (gain or loss) and 113 (basis) will show that they are closely interrelated. The operation of section 113(a)(6), which prescribes basis in the case of tax-free exchanges, is conditioned upon section 112(b) to (e), which deal with gain or loss. "Reorganization" provides for *deferment*—not avoidance—of both gains and losses, *conditioned upon adjustments to basis under section 113.*

This is what Congress meant when, as shown in the Committee reports on the Revenue Act of 1921 (H. Rept. 350, 67th Cong., 1st Sess., p. 10; S. Rept. 275, 67th Cong., 1st Sess., p. 12; H. Rept. 179, 68th Cong., 1st Sess., p. 7; S. Rept. 398, 68th Cong., 1st Sess., p. 7), it said that the basis provisions afford proper safeguards against the misuse of the reorganization provisions. Congress recognized fully the fact that these provisions might be employed by taxpayers in transactions not germane to ordinary business activities and was entirely willing that this should be done relying, among other reasons, upon the fact that ultimately, *by virtue of adjustments to basis,* a sufficiently full measure of tax would be secured.

The decision below defeats the intent of Congress because it fails to observe that the legislators intended to rely on adjustments to basis to check abuse. They did not wish protection by any warping of the definition.

Had Congress considered that the present case, as contended by the Government, was an evasion, it would have promptly amended the definition, as it amended in 1923 the closely related provisions of section 203(b)(1). (c. 294, Sec. 1, 42 Stat. 1560)

IV

The literal application of the definition produces a reasonable result.

When the stock of Averill Corporation was distributed to petitioner, after receipt by that corporation from United Mortgage Corporation of the Monitor stock, petitioner's original basis for gain or loss on the United Mortgage Corporation stock in the amount of $350,000 was allocated, under the provisions of section 113(a)(9) of the Revenue Act of 1928, between the United Mortgage Corporation stock and the Averill Corporation stock, in accordance with the respective fair market values of these stocks, as follows:

Portion of original basis allocated to United Mortgage Corporation stock	$292,674.55
Portion of original basis allocated to Averill Corporation stock	57,325.45
Total original basis of United Mortgage Corporation stock	$350,000.00

Giving the words of the Act their literal meaning, the present effect of the transaction is to permit petitioner to subtract from the $133,333.33 value of the Monitor stock received by her on liquidation of Averill Corporation, the allocated basis figure of $57,325.45 and thus to show a taxable profit at the liquidation of $76,007.88, instead of the gross proceeds, or $133,333.33.

The court below apparently failed to see that the basis on the United Mortgage Corporation stock owned by her was *ipso facto* reduced by the same sum of $57,325.45—*i.e.*, from $350,000 to $292,674.55. The reduction of the basis of the United stock is the safeguard which Congress deemed sufficient to prevent misuse of the reorganization provisions and to make unnecessary any restriction of reorganization to germane business transactions.

Obviously, the statutory scheme, as applied to this case, conforms to good business practice. Disregarding, for a

moment, the mechanics of the transaction, what Mrs. Gregory did was to sell part of the capital assets owned by her for $133,333.33. The Government insists that the measure of taxable income from that transaction is *the gross proceeds of the sale.* Mrs. Greogry's position is that she should be allowed to subtract from the gross proceeds a fair amount representing the cost or other basis of the asset she sold. Her position is plainly reasonable. (Compare *Commissioner v. Logan,* 283 U. S. 404) Whenever a capital asset is sold, a proper amount representing the cost of the asset should be deducted from the sale price to determine the taxable profits. This is what the statute, construed in accordance with the literal meaning of the plain words employed, permits.

A homely illustration will make the *substance* of the transaction plain. A farmer purchases ten bushels of corn at $1 a bushel. He sells two bushels for $3.50. The Government says his income is $3.50. Mrs. Gregory says his income is $1.50.

The reduction of the gross proceeds from a sale by a reasonable element of cost is not only the fair way to arrive at net income but is entirely in line with the purpose of Congress in the 1921 and later Acts to expedite capital transactions.

The foregoing exposes the Government's bold assertion that petitioner is trying to avoid tax on an "ordinary dividend".

V

Pinellas Ice & Cold Storage Company v. Commissioner, 287 U. S. 462, requires reversal of the decision below.

The consistent administrative construction of the definition according to its literal meaning has already been shown. In *Pinellas Ice & Cold Storage Company v. Commissioner,* 287 U. S. 462, the Court disapproved a restricted construction placed upon the definition by the Circuit Court of Appeals of the Seventh Circuit, saying (page 469):

> "But the construction which the court seems to have placed upon clause A, paragraph (h) (1), § 203, we think is too narrow. It conflicts with established practice of the tax officers and if passed without comment, may produce perplexity."

Evidently the Court's purpose was, *first*, not to disturb the established practice of the tax officers and, *second*, not to introduce elements of perplexity. Both of these objects are entirely in accord with a correct construction of the definition and of the intent of Congress. All of the arguments heretofore advanced in this brief squarely support the above quoted portion of this Court's opinion in the *Pinellas Ice & Cold Storage Company* case.

The facts were that an ice company in Florida had transferred all of its property to a new corporation for short-term four-months purchase-money notes and cash. This Court said (page 468)—

> "These notes—mere evidence of obligation to pay the purchase price—were not securities within the intendment of the act and were properly regarded as the equivalent of cash."

With this conclusion we have no difference. We agree that—

> "It would require clear language to lead us to conclude that Congress intended to grant exemption to one who sells property and for the purchase price accepts well secured, short term notes, (all payable within four months) when another who makes a like sale and receives cash certainly would be taxed." [Page 469]

Obviously, this Court was directing its reasoning, not to clause (A) of the definition of "reorganization" (which makes no point whatever of "securities"), but to section 203(b)(3) of the Revenue Act of 1926, which states that no gain or loss shall be recognized where properties are exchanged in reorganization solely for stock or securities, and

to section 203(e), which takes care of the situation where money is involved. It would be a distortion to say that the above-quoted language has anything to do with the definition of "reorganization".

Admittedly, some element of continuity of interest underlies the statutory scheme. It does not underlie the *definition of "reorganization"*. This continuity of interest is not expressed in the definition but in the requirements of section 203(b)(3) and other subsections of that section (section 112 in the 1928 and later Acts) that the consideration consist of securities. The four-months notes did not provide the necessary continuity of interest contemplated by section 203(b)(3). Perhaps six-months notes might have been sufficient. This element of continuity finds its expression in the nature of the "securities" received. Short-term notes were insufficient to afford the necessary continuity. Here again it is section 203(b)(3), not the definition, that is involved.

The foregoing reasoning was adequate to dispose of the entire case and we believe it was so intended by the Court. The Court's reasoning was substantially that of the Board of Tax Appeals, which held against the taxpayer on the very proper ground that this particular kind of a note was not a "security". Indeed, at one place in the opinion, the Court seems to say that it agrees with the position of the Board for the Court states (page 468) that the Board "accordingly and as we think properly, upheld the Commissioner's action".

It must be said, however, with regret, that the *Pinellas* decision has caused considerable confusion, as evidenced by most of the recent decisions of the Board of Tax Appeals and the courts. (See cases cited in the brief of the Commissioner in this case, especially on page 21) The confusion arose out of what appears to be merely a dictum in the *Pinellas* opinion. Endeavoring to make clear that the court below had unduly restricted the definition, this Court, having already disposed of the case, proceeded to show

that a restricted definition was unjustified. In so doing, this Court let fall the observation (page 469) that, in the circumstances, it approved the conclusion below "that the facts disclosed failed to show a '*reorganization*' within the statutory definition". What the Court apparently had in mind was that even if the facts fell within the definition of "reorganization", and we think they did, nevertheless the gain should be recognized because the notes were not securities and the gain, therefore, was not within the protection of section 203(b)(3) and (e). This view of the Court's decision harmonizes with the announced purpose to confirm the settled administrative practice, the desire to avoid perplexity, and the real function of the definition of "reorganization" as a fixed and reliable yardstick which is used to define specific tax results in many other parts of the statute.

The confusion attending what we think is a misinterpretation of a dictum in the Court's opinion in the *Pinellas* case is an excellent illustration of the troubles which follow distortion of the statutory unit of measurement of "reorganization".

Conclusion

In conclusion it is submitted that—

(1) Under settled doctrines of construction, the definition must be given a literal interpretation.

(2) Any theory of interpretation based upon the taxpayer's intent or motive is impractical and unsound.

(3) Congress was fully familiar with the problems involved, and its policies were written into the statute with exceptional care.

(4) The interpretation proposed by the Commissioner is contrary to the intent of Congress and established administrative practice, and will produce confusion, uncertainty, and perplexity.

(5) The interpretation we urge was intended by Congress; protects the revenues against non-germane losses; conforms to established administrative practice; and affords certainty to both the Government and taxpayers.

The decision below should be reversed.

Respectfully submitted,

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EDWARD H. MCDERMOTT,
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APPENDIX

EXHIBIT "A"

CERTAIN PROVISIONS OF THE REVENUE ACT OF 1928, C. 852, 45 STAT. 791-883.

SEC. 101. CAPITAL NET GAINS AND LOSSES.

* * * * * * * * *

(c) *Definitions.*—For the purposes of this title—

* * * * * * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112(g) of this title or under the provisions of section 203(c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) *Adjustment of basis.*—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; but in no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value under section 114(b)(2) or to percentage depletion under section 114(b)(3). In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date, and

(3) In the case of stock the basis shall be diminished by the amount of distributions previously made in respect of such stock, to the extent provided under the law applicable to the year in which the distribution was made.

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is

transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b)(4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(f) *Involuntary conversions.*—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) *Same—effect on future distributions.*—The distribution, in pursuance of a plan of reorganization, by or on

behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115(b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however affected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired upon an exchange described in section 112(b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

* * * * * * * *

(9) *Tax-free distributions.*—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112(g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

* * * * * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property.

* * * * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * * * *

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112(h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

(d) *Other distributions from capital.*—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this subsection shall also apply to distributions from depletion reserves based on the discovery value of mines.

* * * * * * * *

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

* * * * * * * *

EXHIBIT "B"

CERTAIN TREASURY RULINGS ON "REORGANIZATION" PROBLEMS PUBLISHED IN OR PRIOR TO 1921.

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O. D.	970,	5 C. B.	61
A. R. R.	665,	5 C. B.	59
O. D.	1058,	5 C. B.	58
O. D.	1051,	5 C. B.	58
O. D.	1080,	5 C. B.	56
O. D.	1008,	5 C. B.	56
O. D.	1064,	5 C. B.	53
S. O.	115,	5 C. B.	47
L. O.	1062,	4 C. B.	168
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O. D.	932,	4 C. B.	46
O. D.	783,	4 C. B.	45
O. D.	955,	4 C. B.	44
O. D.	912,	4 C. B.	30
S. O.	72,	3 C. B.	59
A. R. R.	173,	3 C. B.	58
A. R. M.	67,	3 C. B.	54
O. D.	693,	3 C. B.	40
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S. O.	4,	2 C. B.	307
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S.	1294,	2 C. B.	41
O. D.	480,	2 C. B.	39
A. R. R.	156,	2 C. B.	39
O. D.	418,	2 C. B.	33
O. D.	479,	2 C. B.	29
A. R. R.	67,	2 C. B.	27
L. O.	942,	1 C. B.	300
O. D.	335,	1 C. B.	46
O. D.	204,	1 C. B.	46
T. B. R.	39,	1 C. B.	45
O. D.	308,	1 C. B.	43
O. D.	98,	1 C. B.	43
T. B. R.	25,	1 C. B.	39
A. R. R.	6,	1 C. B.	30

EXHIBIT "C"

THE REVENUE BILL OF 1921

(1) *Legislative history of the definition of "reorganization":*

As introduced in the House on August 15, 1921 (61 Cong. Rec. 5036), and as passed by the House, section 203 of the bill which became the Revenue Act of 1921 contained the following definition of "reorganization":

> "The word 'reorganization,' as used in this paragraph, includes a merger, consolidation (however effected), recapitalization, or a mere change in identity, form, or place of organization of a corporation;"

When the bill was reported to the Senate on September 21, 1921 (61 Cong. Rec. 5711), the definition read as follows:

> "The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of substantially all the stock or substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);"

While the bill was being read in the Senate, Mr. McCumber, for the Committee on Finance, offered an amendment (61 Cong. Rec. 6549) the effect of which was to strike the following words from the definition:

> "merger or consolidation (including the acquisition by one corporation of substantially all the stock or substantially all the properties of another corporation)"

and insert in lieu thereof the following:

> "merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of

shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)''

After debate (61 Cong. Rec. 6549-6550, 6561-6569) this amendment was adopted (61 Cong. Rec. 6569) so that as passed by the Senate the definition read as follows:

''The word 'reorganization,' as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected);''

The Conference Committee accepted the amendment made on the floor of the Senate and the definition as so amended, and as last above set forth, was contained in the bill as finally approved by the President.

(2) *Extract from S. Rept. 275, 67th Cong., 1st. Sess., p. 11:*

EXCHANGES OF PROPERTY FOR PROPERTY.

* * * * * * * * * *

Under existing law ''when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any * * *.'' Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily

realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value. These classes comprise the cases where productive property (other than stock in trade or property held primarily for sale) used in a trade or business is exchanged for property of a like kind or use; where in any corporate reorganization or readjustment stock or securities are exchanged for stock or securities of a corporation which is a party to or results from such reorganization; and where an individual or individuals transfer property to a corporation and after such transfer are in control of such corporation.

The preceding amendments, if adopted, will, by removing a source of grave uncertainty and by eliminating many technical constructions which are economically unsound, not only permit business to go forward with the readjustments required by existing conditions but also will considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges.

Proper safeguards are found in subdivision (d), which provides that where property is exchanged for other property or where property is involuntarily converted into cash and the proceeds of such conversion are used to replace the property converted, or where a wash sale is not recognized, the property received in exchange shall be treated as taking the place of the original property.

FILE COPY

IN THE

Supreme Court of the United States

October Term, 1934

EVELYN F. GREGORY,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF AMICI CURIAE

ALBERT E. JENNER,
A. CALDER MACKAY,
GEORGE M. MORRIS,
WILLIAM D. NANCE,
CHARLES B. ROCH,
WHITNEY NORTH SEYMOUR,
HARRY N. WYATT,

Counsel for Petitioner.

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IN THE

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EVELYN F. GREGORY,

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GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF AMICI CURIAE

Pursuant to leave heretofore granted, the undersigned submit this brief *amici curiae.*

The citation to the opinions below, the reference to the jurisdiction of this Court, and the specifications of errors are set forth in petitioner's brief in support of the petition for the writ of certiorari (pages 8-10) and are not set forth herein. Citations

to the relevant statutes are contained in the argument.

QUESTION PRESENTED

Are transactions, expressly within the reorganization provisions of the Revenue Act of 1928, conducted to the end that capital gain may be realized and taxed as such, to be denied their usual effect if the purpose of such transactions is to avoid greater taxes which would result if the sale of the capital asset were consummated in one of several other ways?

IMPORTANCE OF THE CASE

The provisions of law, the interpretation of which is involved in this proceeding, are to be found in the Revenue Acts of 1924, 1926, 1928 and 1932. In large measure the same provisions are repeated in the Revenue Act of 1934. During this ten-year period from 1924 to 1934, while the statutory law relating to transactions involved in corporate reorganizations and relating to the taxation of capital gains remained unchanged, thousands of transactions involving questions of tax liability of corporations and individuals have been consummated, in reliance first, upon the principle that tax liability is determined by the language of the statute and not by an assumed, but unexpressed, legislative intent (*Crooks* v. *Harrelson*, 282 U. S. 55) and second, is not determined by the motive of the taxpayer (*U. S.* v. *Isham*, 70 Wall. 496, *Bullen* v. *Wisconsin*, 240 U. S. 625). Despite these time-honored and presumably well-settled principles of construction, the

Circuit Court of Appeals in effect abandoned them in this case and substituted the principle that the statute should not be literally applied and that the motive of the taxpayer controls.

Such a rule, varying as it necessarily must with the mental processes of each judge called upon to enforce it, would produce untold confusion in disposing of those tax problems already existing by reason of transactions consummated. Such a rule would make it impossible for any taxpayer or his lawyer, in considering future transactions, to determine whether or not the form and manner in which those transactions are to be consummated would result in taxation, or under which of numerous possible provisions of the Revenue Acts such transactions might be taxed.

The very purpose, therefore, of the capital gain provisions to induce (by a reduction in the tax rate) the free and normal sale of capital assets is defeated. Certainty promotes such transactions; uncertainty deters them.

STATEMENT OF THE CASE

The petitioner, Mrs. Gregory, owned all the capital stock of the United Mortgage Corporation. Included among the assets of United Mortgage Corporation was 1,000 shares of Monitor Securities Corporation.

On September 18, 1928, Averill Corporation was organized. Pursuant to a plan of reorganization, United Mortgage Corporation transferred part of its assets, consisting of the 1,000 shares of stock of Monitor Securities Corporation, to Averill Corporation in exchange for the issue by Averill Corporation of all

of its stock to Mrs. Gregory. Mrs. Gregory did not surrender her stock in United Mortgage Corporation and still retains it.

On September 24, 1928, the Averill Corporation was dissolved and distributed in liquidation to Mrs. Gregory, the holder of all of its stock, all of its assets, consisting of the stock in the Monitor Securities Corporation. Also on September 24, 1928, Mrs. Gregory sold the 1,000 shares of Monitor Securities Corporation for cash.

In her income tax return Mrs. Gregory reported a capital gain from the above transaction of $76,007.88 and paid the tax shown thereon to be due. That profit was arrived at by apportioning her cost of United Mortgage Corporation stock, in part, to the stock of Averill Corporation distributed to her and subtracting said cost of Averill Corporation from the value of the Averill stock, which was $133,333.33.

The Commissioner of Internal Revenue determined that she had received an ordinary dividend from the United Mortgage Corporation upon the distribution to her of Monitor Stock and added $133,333.33 to her income, computing tax thereon at ordinary surtax rates. The Board of Tax Appeals sustained the taxpayer and held that Mrs. Gregory realized a capital gain upon the distribution to her in liquidation of the Monitor stock.

The Circuit Court of Appeals, disagreeing with the taxpayer, the Commissioner and the Board of Tax Appeals, held that Mrs. Gregory received a taxable dividend upon the distribution to her of the stock of Averill Corporation and neither a capital gain nor a taxable dividend upon the distribution of the Monitor stock.

SUMMARY OF THE ARGUMENT

The Circuit Court erroneously relied upon *Pinellas Ice and Cold Storage Company* v. *Commissioner* in its decision in this case.

The practical problem in this case is to determine the tax due on the gain derived from the dealings in a capital asset.

The statute is a deliberately planned, integrated and seasoned structure covering, in detail, the disposition of capital assets, exchanges and distribution in connection with corporate reorganizations and the subsequent disposal of stocks, securities and properties received in such reorganizations. Each step taken in the reorganization here involved was contemplated and specifically provided for in the statute. The statute is a carefully articulated plan and there is no room therein for interpolation of an intendment beyond the words used in the statute. It is impossible to depart from the interlocking provisions of the statute without rendering uncertain all capital transactions involved in corporate reorganizations and thus defeating the intention of the Congress to induce the free and normal sale and exchange of capital assets by granting postponement or a lower rate of tax on the profits arising from such transactions.

ARGUMENT

I.

The Court of Appeals erroneously relied upon Pinellas Ice and Cold Storage Company v. Commissioner in its decision in this case.

It was said by the Circuit Court of Appeals (R. 36) in answer to the argument that the statute should be

specifically followed, that in *Pinellas Ice and Cold Storage Company* v. *Commissioner* (287 U. S. 462) "the violence done the literal interpretation of the words is no less than we do here." We think this is entirely mistaken. The *Pinellas* case was actually a decision that the short term notes used as consideration for an exchange did not meet any reasonable definition of the word "securities" as used in Section 112 (b) (4) of the taxing statute. No violence is done to the statutory language by that decision.

In the second place the opinion in the *Pinellas* case dealt with the definition (Sec. 112 (i) (l) (A)) of reorganization by way of "merger or consolidation," including the parenthetical clause which follows. That definition has been recognized as obscure for a number of years and is one leaving much latitude in construing the statute. The case at bar, however, involves the specific definition of reorganization in Section 112 (i) (l) (B). The words are plain; the meaning is clear. Such a literal definition leaves no doubt to be construed.

The *Pinellas* case is, therefore, no authority for the decision below. That case offers no support for a decision in direct conflict with the admittedly clear terms of the sections of the statute involved in the present case.

II.

The practical problem in this case is to determine the tax due on the gain derived from dealings in a capital asset.

The Revenue Act of 1924 and succeeding Acts, including the Revenue Act of 1928, here involved, provided a varying amount of taxes which could be im-

posed upon the realization of gains arising from dealings with capital. The computation of such tax depends upon the form of the transaction actually pursued. For illustration; in the first place, there could be a tax on the realization of gain from the sale of a capital asset by a corporation at the corporate rate of 12% (Section 13). In the second place, if the proceeds of the gain from a sale of a corporate capital asset were distributed by a corporation, there would be a dividend taxable to the stockholder at surtax rates (Section 115 (a), Section 25 (a)) in addition to the tax paid by the corporation on the original gain. In the third place, if the corporation realizing the gain were liquidated thereafter, the gain would be taxable to the corporation (Section 13) and to the stockholder, a second time, as a gain to him on liquidation (Section 115 (c)). In the fourth place, if the property were first liquidated from the corporation and then sold by the individual stockholder, there would be one tax to him on his gain from liquidation (Section 115 (c)) and a second tax, if he sold the property at a profit (Section 112 (a)). In the fifth place, the gain from liquidation of the corporation might be taxed as ordinary gain or capital gain, depending upon whether the gain realized fell within or without the definition of capital gain as contained in Section 101.

From the foregoing it will be seen that the problem in this and similar cases dealing with gains from capital assets is not merely whether *a* tax is imposed, but is a problem of selecting the particular tax intended by the Congress to be imposed upon the particular transaction from among the several taxes which might be imposed. It should be apparent that

there is a well rounded plan of specific and detailed provisions relating to the tax effect of changes of ownership of capital assets. This plan began in the Revenue Act of 1924 and continued in subsequent Revenue Acts.

Both by reason of the number of such provisions involved in the various steps in this case and because of the meticulous care with which those steps were carried out in conformity to the statutory provisions, this case well serves as a general illustration of the statutory plan and is important primarily because it clearly brings home the necessity of adherence to the statute in the decisions of the Courts in order that untold confusion may be avoided, both as to transactions already consummated and as to transactions which may be consummated.

It is important to bear in mind that the gain with which the case is concerned is a gain from dealings in a capital asset; namely, the 1,000 shares of the capital stock of Monitor Securities Corporation. The measure of the profit derived from those dealings and the extent of the tax to be imposed thereon is the sole issue in the case. At some point all parties are agreed that a tax liability arises. The problem is to select the tax which the statute imposes.

When it became apparent that the stock of Monitor Securities Corporation could be profitably sold and, in the judgment of the parties concerned, it should be sold, the remaining problem was to consider the effect of such a sale upon the taxes that would be due upon its consummation. It is idle to assume that either this transaction or any other involving substantial sums of money has been consum-

mated during the last fifteen years without some consideration being given to the effect, in terms of taxes, of what is done. In fact the failure to consider taxes in connection with capital realizations may easily result in such multiple taxes as will in large measure turn an apparently profitable transaction into an actual loss, due regard being had to the fact that out of profits realized in the first instance tax must be paid and the remaining proceeds must seek reinvestment on a profitable basis, in order that capital may not be impaired and that income may continue to be realized. It is to the interest both of the citizen and the Government that these two objectives be attained.

In the absence of taxation the simplest procedure would have been for the United Mortgage Corporation to sell the Monitor stock and distribute the proceeds to Mrs. Gregory. This would have resulted in a profit of the difference between the sales price of $133,333.33 and the cost to United Mortgage Corporation of $10,413.07, or $122,920.26. At the corporate rate of tax of 12 per cent (Section 13, Revenue Act of 1928), the first tax on this transaction would have been $14,550.43. The distribution of the sales price, less the corporate tax, as an ordinary dividend to Mrs. Gregory would have increased her individual income, subject to surtax, in the amount of $118,782.90. This amount added to her ordinary income (R. 28) would have resulted in a second tax of $17,269.07, payable this time by Mrs. Gregory but all attributable to the sale of this single capital asset. The two taxes, corporate and individual, on the transaction so executed would have been $31,819.50, a sum more than 25 per cent of the

profit and nearly 25 per cent of the gross sales price.

Since the assets sold amounted to over 16 per cent (R. 23) of the total value of Mrs. Gregory's stock in United Mortgage Corporation, the transaction obviously represented a substantial return of capital so far as she was concerned, and a transaction carried through as above outlined would give no effect to this capital realization. In view of the policy of the law with respect to capital gains (Section 101, Revenue Act of 1928) calling for liberal interpretation in favor of the taxpayer (*Burnet* v. *Harmel*, 287 U. S. 103; *Helvering* v. *New York Trust Company*, 292 U. S. 455), a tax of 25 per cent on a single capital gain certainly is not to be favored in the construction of the law, and steps taken in reduction of such a tax to the amount found by the Board of Tax Appeals certainly do not warrant attack by the Government or deserve the comment of the Circuit Court in this case (R. 37).

Instead of adopting a procedure which would result in a maximum tax under the circumstances the taxpayer selected a route by which two results were accomplished within the spirit and the literal terms of the statute. First, the capital gain realized would be taxed as such at 12½ per cent (Sec. 101), and second, due effect would be given in the computation of the tax to the actual partial realization by Mrs. Gregory of the cost of part of her stock in the United Mortgage Corporation (Sec. 115 (c)).

The Board of Tax Appeals understood this election and objective of the taxpayer clearly and approved of both. The Court of Appeals, however, ignored the provisions of the statute and imposed a tax as though a dividend had been distributed to Mrs.

Gregory (Sec. 115 a). As a consequence the Circuit Court's decision results in a tax amounting to $22,856.63 or over 30 per cent of Mrs. Gregory's capital gain. The decision of the Circuit Court clearly fails to give effect to the policy of the Congress to limit to 12½ per cent the tax upon capital net gains.

From this we pass to an examination of the several steps actually taken, to demonstrate that those steps, severally and together, fit exactly into the plan and spirit of the statute and result in the imposition of a single capital gain tax in accord with the intention of the Congress expressed in the statute.

III.

The statute is a deliberately planned, seasoned and integrated structure covering, in detail, the disposition of capital assets, exchanges and distributions in connection with corporate reorganizations and the subsequent disposal of stocks, securities and properties received in such reorganizations. Each step taken in the reorganization here involved was contemplated and specifically provided for in the statute.

The statute involved was enacted in all the essentials here applicable in 1924, and re-enacted in 1926, 1928, 1932 and, in large measure, in 1934. The very detail of specification in its provisions indicates the intention to write a statute which "results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom."* Continued re-enactment is the best indication of legislative satisfaction with the result.

---

* House of Representatives Report No. 179, 68th Congress, 1st Session, to accompany H. R. 6715, February 11, 1924, p. 13.

Applications of the statute to the transactions accomplished in the case at bar illustrate the detailed extent of the Congressional contemplation and the integration of each step into the structure as a whole.

III-A.

The United Mortgage Corporation transferred to the Averill Corporation 1,000 shares of the capital stock of Monitor Securities Corporation in exchange for all the capital stock of Averill. This step in the series of transactions involved was within the provisions of Section 112 (b) (4) of the Revenue Act of 1928.

The United Mortgage Corporation transferred to the Averill Corporation 1,000 shares of the capital stock of the Monitor Securities Corporation in exchange for all the capital stock of Averill.

Under the Revenue Act of 1918, that transaction, standing alone, would presumably have resulted in taxable gain, although there is no decision of this Court to that effect. The question was involved in *West Point Investment Company,* 1 B. T. A. 436, and in *Wallis Tractor Company,* 3 B. T. A. 981, 999, in both of which cases it was held that a corporate taxpayer realized gain, under the Act of 1918, by the transfer of some or all of its assets for all of the stock of a newly organized corporation.

To demonstrate that under the Revenue Act of 1928 the above first transaction involved in this case is literally within the terms of the statute, it is only necessary to cite Section 112 (b)(4) and Sections 112 (i)(1) and (2), interpolating therein the property and corporate names involved. This citation of Section 112 (b) (4) with the above interpolations reads as follows:

"SEC. 112. RECOGNITION OF GAIN OR LOSS."

"(b) *Exchanges solely in kind.*—"

"(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation"—*United Mortgage Corporation*—"a party to a reorganization exchanges property." —*1,000 shares of the capital stock of Monitor Securities Corporation*—"in pursuance of the plan of reorganization, solely for stock or securities in another corporation" —*capital stock in Averill Corporation*—"a party to a reorganization."

The stock of Monitor Corporation was property (*DeGaney* v. *Lederer,* 250 U. S. 376-380; *Burnet* v. *Brooks,* 288 U. S. 378, 391; *Commissioner* v. *Greene,* 42 Fed. (2d) 852).

Pursuing the same interpolation, the transaction falls within the definition of a reorganization, as follows:

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation"—*United Mortgage Corporation* —"of all or a part of its assets"—*1,000 shares of the capital stock of Monitor Securities Corporation*—"to another corporation"—*Averill Corporation*—"if immediately after the transfer the trans-

> feror" — *United Mortgage Corporation* — "or its stockholders" — *Mrs. Gregory* — "or both are in control of the corporation" — *Averill Corporation*—"to which the assets are transferred, * * *."

Further pursuing the above, the interpolation in Section 112 (i) (2) reads as follows:

> "(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization"—*Averill Corporation* — "and includes both corporations in the case of an acquisition by one corporation"—*United Mortgage Corporation*—"of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."—*all the stock of Averill Corporation.*

The term "control" is defined in Section 112 (j) as meaning "the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." As Mrs. Gregory owned all the stock of Averill Corporation she was clearly in "control."

Here then was a "reorganization" exactly within the definition of the statute in Section 112 (i) (l) (B) and an exchange exactly as provided for in Section 112 (b) (4). To effect the expressed intent and purpose of Congress the gain on such transaction is not recognized but is merely postponed until subsequent disposition of the securities received in such reorganization. Let us pursue that postponement through the next step taken in the case at bar.

III-B.

The United Mortgage Corporation distributed to Mrs. Gregory, as its sole stockholder, the stock of the Averill Corporation without the surrender of her stock in United Mortgage Corporation. This transaction resulted in no taxable gain to Mrs. Gregory under the specific provisions of Section 112 (g) of the Revenue Act of 1928.

The United Mortgage Corporation distributed to Mrs. Gregory, as its sole stockholder, the stock of the Averill Corporation without the surrender of her stock in United Mortgage Corporation. Section 112 (g), with appropriate interpolations, reads as follows:

> "(g) *Distribution of stock on reorganization.*—
>
> "If there is distributed, in pursuance of a plan of reorganization, to a shareholder" — *Mrs. Gregory*—"in a corporation a party to the reorganization" — *United Mortgage Corporation*—"stock or securities in such corporation or in another corporation a party to the reorganization" — *Averill Corporation* — "without the surrender by such shareholder" — *Mrs. Gregory* — "of stock or securities in such a corporation"—*United Mortgage Corporation*—"no gain to the distributee"—*Mrs. Gregory*—"from the receipt of such stock or securities shall be recognized."

The distribution by United Mortgage Corporation to Mrs. Gregory of the stock of Averill Corporation is the particular transaction to which the Circuit Court of Appeals in its opinion in this case attributes taxable gain. It is seen from the foregoing that this transaction, coupled with the antecedent one dis-

cussed under III-A., fits literally within the terms of the reorganization provisions of the statute and, unless the exact language of the statute is to be ignored, no gain can possibly attach to the distribution of Averill stock.

That the language was carefully chosen to accomplish this result is fully established by the legislative history of this Section. The transaction here dealt with is a precise parallel of the transactions held taxable by this Court in *U. S.* v. *Phellis,* 257 U. S. 156, and *Rockefeller* v. *U. S.,* 257 U. S. 176, both decided November 21, 1921, construing the provisions of the Act of 1913. The changed policy represented by the provisions of the Revenue Act of 1924 and repeated in the subsequent Acts is fully dealt with in the petitioner's brief in this case, on pages 14-23 and will not be repeated here. Clearly the Circuit Court cannot be supported in its finding that this transaction —the receipt by Mrs. Gregory of the Averill stock— is subject to taxation.

Here again the distribution of the Averill stock is exactly within the purview of the statute (Section 112 (g)). The expressed purpose of Congress is not to recognize gain upon such a distribution but again to postpone recognition until subsequent disposition of the Averill stock. The postponed recognition of profit must, therefore, be pursued into the subsequent transactions.

III-C.

Under the provisions of Section 113 (a) (9) of the Revenue Act of 1928, the basis of cost of Mrs. Gregory's United Mortgage Corporation stock was apportioned in part to the newly acquired Averill Corporation stock.

Not only did the sections of the statute involved in this case define in precise and definite terms those transactions to which taxable gain should or should not be attributed but where taxable gain was not to be attributed to a transaction, the sections further define the effect of those provisions upon subsequent transactions dealing with the same property. At this point we turn to the statute again to determine the effect of the antecedent transactions upon Mrs. Gregory's basis for subsequent transactions, both as affecting her stock in United Mortgage Corporation and her new stock in Averill Corporation.

Section 113 (a) (9), by exact reference to Section 112 (g), *ante*, outlines the basis for subsequent transactions in these stocks by Mrs. Gregory. With interpolations as before, this Section reads as follows:

> "SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS."
>
> "(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—"
>
> "(9) *Tax-free distributions.*—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in Section 112 (g), the basis in the case of the stock in respect of which the distribution was made"—

> *United Mortgage Corporation*—"shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock" — *United Mortgage Corporation* — "and the stock" — *Averill Corporation* — "or securities distributed;"

Under the authority granted in Section 113, the Commissioner promulgated Regulations 74, Article 600. This regulation, prior to its amendment in 1929, and, as originally drawn and in force at all times material to this case reads, so far as here pertinent, as follows:

> "Art. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules;"
>
> "(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quo-

> tient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class."

The computation of Mrs. Gregory's investment in Averill Corporation stock, arrived at in accordance with the foregoing regulations, is set forth in the Record, page 23.

The foregoing provisions of the statute and regulations have an important effect upon subsequent transactions of United Mortgage Corporation, of Averill Corporation, and upon Mrs. Gregory's individual transactions in those stocks. As so applied, Mrs. Gregory's cost, originally $350,000.00, of her stock in United Mortgage Corporation is reduced by $57,325.45, the apportioned cost to Averill Corporation. Upon subsequent disposition of United Mortgage Corporation stock, her cost per share, therefore, is proportionately reduced and her gain increased. In like manner, upon a disposition of Averill stock the basis is provided for under the law and the regulations. Moreover, in the case of dividends in cash, there is a further important effect. Section 112 (h), following Section 112 (g), *ante*, provides, with interpolations, as follows:

> "(h) *Same—effect on future distributions.* —The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization,"—*United Mortgage Corporation*—"of its stock or securities or stock or securities in a corporation a party to the reorganization," — *Averill Corporation*—"shall not be considered a distribution of earnings or profits within the meaning of Section 115 (b) for the purpose of deter-

mining the taxability of subsequent distributions by the corporation."—*United Mortgage Corporation.*

So far as material, Section 115 (b) reads as follows:

> "SEC. 115. DISTRIBUTIONS BY CORPORATIONS."
>
> "(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits."

If, as determined by the Circuit Court of Appeals, the distribution by United Mortgage Corporation of the Averill stock was an ordinary dividend, contrary to the specific direction contained in Section 112 (g), and to the provisions of Section 115 (b), then Section 112 (h) must be disregarded. If Section 115 (b) applies to the distribution of the Averill stock, the earnings available for distribution thereafter by United Mortgage Corporation are reduced by $133,333.33, thereby making it possible for United Mortgage Corporation to distribute, as a charge against capital and not as a charge against income, an equivalent amount in cash to Mrs. Gregory free from tax. In precise language and with obviously full knowledge of the interlocking effect of such transactions, Congress provided that the distribution under Section 112 (g) should not have the effect of a distribution of earnings, so that when earnings were really distributed, there would be no question as to their taxability as dividends. To hold, as the Circuit Court of Appeals holds in this case, that a distribution falling

literally within the terms of Section 112 (g) is a distribution of a taxable dividend, is to throw into confusion all subsequent transactions of United Mortgage Corporation and all others in like situations in respect of their earnings.

If the Averill Corporation stock distribution did not accomplish an apportionment of the cost of stock by the United Mortgage Corporation and Averill Corporation, then it must also follow that on a sale of United Mortgage Corporation stock Mrs. Gregory's basis is $350,000, a result again in direct conflict with the provisions of the statute and again throwing the interpretation of the statutory provisions into hopeless confusion, producing possibilities of double taxation and opening avenues of escape from taxation depending upon the special situations surrounding each particular case.

From the foregoing it will be seen that as a corollary of the postponement of the recognition of gain (explained in captions "A" and "B") the new property is taken by the present holder "with the profit on." To accomplish this an allocation of the basis of the original property is specifically made by the Congress in Section 113 (a) (9) as explained. Such a provision necessarily contemplates a subsequent transaction upon which the postponed profit will be recognized and the gain computed against the basis provided. That transaction took place in the next step taken in the present case.

III-D.

Averill Corporation dissolved and distributed to Mrs. Gregory, in exchange for her stock in that corporation, the 1,000 shares of stock of Monitor Securities Corporation. This was a distribution in liquidation as defined in Section 115 (c) of the Revenue Act of 1928. It was specifically excluded from consideration as a dividend by the provisions of Sections 115 (a) and (b) and 112 (h) of that Act.

Averill Corporation dissolved and distributed to Mrs. Gregory, in exchange for her stock in that corporation, the 1,000 shares of stock of Monitor Securities Corporation. That distribution of the stock of Monitor Securities Corporation in the dissolution of Averill Corporation is the transaction reported by the taxpayer in her return as subject to capital gain tax.

Section 115 of the Revenue Act of 1928 contains explicit directions covering the taxation of corporate distributions. The transaction hereinabove outlined is directly covered by Section 115 (c) which, with interpolations, reads as follows:

> "SEC. 115 DISTRIBUTIONS BY CORPORATIONS."
>
> "(c) *Distributions in liquidation.*--Amounts distributed in complete liquidation of a corporation" — *Averill Corporation* — "shall be treated as in full payment in exchange for the stock"—*Averill stock, apportioned cost $57,325.45*—"and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee"—*Mrs. Gregory* — "resulting from such exchange" — *Averill for Monitor Securities* — "shall be determined under Section 111, but

shall be recognized only to the extent provided in Section 112 * * *."

An examination of Section 111 discloses that there are no adjustments in the instant case to be made, as therein provided.

An examination of Section 112 discloses no circumstances in the instant case requiring the exclusion from taxable gain of any portion of the Monitor stock other than the cost attributed to it by reason of the apportionment of the original basis of cost of United Mortgage Corporation stock.

Sections 115 (a) (b) and (c) define in both inclusive and exclusive terms those distributions by corporations which are and are not to be deemed taxable dividends. To the extent necessary for the purpose of this brief, Section 115 (c) has been quoted on page 22 above. By reference to Section 112 (h) quoted on page 19 above, Section 115 (c) completes the statutory scheme. The last sentence of 115 (c), containing this reference, reads as follows:

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS."

"(c) *Distributions in liquidation.* * * * In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of Section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation."

The foregoing analysis has shown, step by step, the manner in which the transactions in this case fit literally and by intendment into the statutory words and into the statutory plan. The steps so analyzed are those leading up to and including the transactions reported as taxable by Mrs. Gregory and approved by the Board, determined by the Commissioner to be taxable and upon which the Circuit Court imposed tax.

The legal chain was completed by Section 101 (c) (8) (C) which, to the extent that Mrs. Gregory's investment in United Mortgage Corporation stock had been held more than two years, provided that the stock of Averill Corporation acquired by her should be treated as taking the place of the United Mortgage Corporation stock for the purpose of determining the period of time during which such stock was held. By reason of this extension of time, applicable to Averill stock, the gain realized on the liquidation of that stock was taxable at capital gain rates. That gain was realized by the exchange of Monitor stock for the Averill stock in the liquidation of the Averill Corporation.

Here once more the step taken is specifically provided for in the statute (Sec. 115 (c) and Sec. 101). Congress, however, provides for no further postponement of recognition of gain in such a liquidation. Accordingly gain is computed against the basis provided (caption "C"). Here is the ultimate point at which Congress provides for taxing the postponed profit.

IV.

The statute is a carefully articulated plan to provide in specific terms just how capital transactions are to be taxed. There is no room therein for interpolation of an intendment beyond the words used. It is impossible to depart from these interlocking provisions without rendering uncertain all capital transactions involved in corporate reorganizations.

The Court below has previously said, in *Delaware and Hudson Company* v. *Commissioner*, 65 F. (2d) 292, 293:

> "A taxing system so detailed and particular as ours does not admit of the same flexibility of interpretation as one in more general terms. Perhaps its very refinement may defeat its purpose; elaboration often does. But the more articulate the expression, the less room remains for intendment beyond the words used."

It would be difficult to find a happier statement of the principle which the same court appears to have violated in the decision rendered in the present case. The statute under construction is highly articulated. Step after step has been foreseen and prescribed with exact particularity. Each provision is a part of a fabric designed to cover every reasonably anticipable situation. A departure from a literal interpretation at any place in the structure distorts or vitiates the remaining provisions. The sequence must be followed literally through all the interlocking provisions to accomplish the expressed intent and purpose of the Congress.

The primary purpose of this brief has been to call to the attention of the Court the fact that Sections 111 to 115, inclusive, of the Revenue Act of 1928,

and the corresponding sections of earlier and later Acts, represent a carefully articulated plan which, together with Section 101, the capital gain provision, undertook to delimit with extreme care and in specific terms just how capital transactions were to be taxed. It is impossible to depart from these specific provisions without doing violence to all rules of statutory construction. It is impossible to depart from any one of these specific interlocking provisions without rendering uncertain the application of the income tax to all capital transactions which relate in any way to corporate stock or securities or to property exchanged therefor or derived therefrom. Such uncertainty will deter transactions in capital assets which the capital gain provisions by granting a lower rate of tax are intended to induce. Such uncertainty of construction, if adopted, would produce endless litigation, would result in the collection of unjust and unintended taxes in many cases, and would permit in many others an entire escape from taxes intended by Congress to be imposed.

Counsel believe that this Court should reverse the decision of the Circuit Court of Appeals for the Second Circuit and should affirm the decision of the Board of Tax Appeals. It is believed that the decision of this Court should announce, in effect, that the spirit of this statute requires that it be construed as written. This means that the words in Section 112 (i) (l) (B) defining a reorganization are to be lit-

erally applied so that subsequent transactions will be taxed in the manner set forth in the related sections of the statute.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 127.—October Term, 1934.

Evelyn F. Gregory, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 7, 1935.]

Mr. Justice Sutherland delivered the opinion of the Court.

Petitioner in 1928 was the owner of all the stock of United Mortgage Corporation. That corporation held among its assets 1,000 shares of the Monitor Securities Corporation. For the sole purpose of procuring a transfer of these shares to herself in order to sell them for her individual profit, and, at the same time, diminish the amount of income tax which would result from a direct transfer by way of dividend, she sought to bring about a "reorganization" under § 112 (g) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 818, set forth later in this opinion. To that end, she caused the Averill Corporation to be organized under the laws of Delaware on September 18, 1928. Three days later, the United Mortgage Corporation transferred to the Averill Corporation the 1,000 shares of Monitor stock, for which all the shares of the Averill Corporation were issued to the petitioner. On September 24, the Averill Corporation was dissolved, and liquidated by distributing all its assets, namely, the Monitor shares, to the petitioner. No other business was ever transacted, or intended to be transacted, by that company. Petitioner immediately sold the Monitor shares for $133,333.33. She returned for taxation as capital net gain the sum of $76,007.88, based upon an apportioned cost of $57,325.45. Further details are unnecessary. It is not disputed that if the interposition of the so-called reorganization was ineffective, petitioner became liable for a much larger tax as a result of the transaction.

The Commissioner of Internal Revenue, being of opinion that the reorganization attempted was without substance and must be

disregarded, held that petitioner was liable for a tax as though the United corporation had paid her a dividend consisting of the amount realized from the sale of the Monitor shares. In a proceeding before the Board of Tax Appeals, that body rejected the commissioner's view and upheld that of petitioner. 27 B. T. A. 223. Upon a review of the latter decision, the circuit court of appeals sustained the commissioner and reversed the board, holding that there had been no "reorganization" within the meaning of the statute. 69 F. (2d) 809. Petitioner applied to this court for a writ of certiorari, which the government, considering the question one of importance, did not oppose. We granted the writ. 293 U. S. —.

Sec. 112 of the Revenue Act of 1928 deals with the subject of gain or loss resulting from the sale or exchange of property. Such gain or loss is to be recognized in computing the tax, except as provided in that section. The provisions of the section, so far as they are pertinent to the question here presented, follow:

"Sec. 112 (g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

. . .

"(i) *Definition of reorganization.*—As used in this section . . .

"(1) The term 'reorganization' means . . . (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, . . ."

It is earnestly contended on behalf of the taxpayer that since every element required by the foregoing subdivision (B) is to be found in what was done, a statutory reorganization was effected; and that the motive of the taxpayer thereby to escape payment of a tax will not alter the result or make unlawful what the statute allows. It is quite true that if a reorganization in reality was effected within the meaning of subdivision (B), the ulterior purpose mentioned will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. *United States* v. *Isham,* 17 Wall. 496, 506; *Superior Oil*

Co. v. *Mississippi*, 280 U. S. 390, 395-6; *Jones* v. *Helvering*, 71 F. (2d) 214, 217. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. The reasoning of the court below in justification of a negative answer leaves little to be said.

When subdivision (B) speaks of a transfer of assets by one corporation to another, it means a transfer made "in pursuance of a plan of reorganization" [§ 112(g)] of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case here. Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. No doubt, a new and valid corporation was created. But that corporation was nothing more than a contrivance to the end last described. It was brought into existence for no other purpose; it performed, as it was intended from the beginning it should perform, no other function. When that limited function had been exercised, it immediately was put to death.

In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

Judgment affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.